Commission of Inquiry
into
Residential Tenancies

Ontario

Financing Residential Rental Accommodation: A Survey

Environics Research Group Ltd.

Research Study No. 23

FINANCING RESIDENTIAL RENTAL ACCOMMODATION: A SURVEY

by

Environics Research Associates Inc.

Research Study No. 23

Commission of Inquiry

into Residential Tenancies

Toronto

Published by the Commission of Inquiry
into Residential Tenancies, October 1985

Printed in Canada

ISSN - 0820-7729
ISBN - 0-7729-1176-2

Copies of this report are available from
the Ontario Government Bookstore,
880 Bay Street,
Toronto, Ontario,
M7A 1N8.
Telephone: 416-965-6015; toll-free 1-800-268-7540;
area code 807, ask operator for Zenith 67200.

The views expressed in this paper are those of the
author and not necessarily those of the Commission.

Table of Contents

Table of Contents cont'd:

Table of Contents cont'd:

Table of Contents cont'd:

FINANCING RESIDENTIAL RENTAL

ACCOMMODATION: A SURVEY

1.0 INTRODUCTION

The Commission of Inquiry into Residential Tenancies asked Environics Research Group to carry out a survey of persons experienced in lending for multi-family residential rental accommodation.

The survey was to deal with,

(1) how the financial sector operates in relation to the financing and operations of rental accommodation; and

(2) the effects of rent review upon this relationship.

We were asked to survey respondents on the following specific matters:

* funding sources;
* roles of funding sources;
* which types of landlords use which types of sources;
* the methods of determining building values, e.g., market value vs. economic value;
* basis for determining lending ratios;
* perceptions of risk, rates of return and liquidity;
* demonstrable effects of rent review;
* perceived effects of rent review;
* unresolved effects of rent review.

1.1 METHODOLOGY

Over a period of two and a half weeks in June, 1985, interviews were conducted with 22 people at 19 lending organizations: five banks, four life insurance companies, three trust companies, and five private lending houses. Several interview sessions included more than one person. Respondents were selected

because of their extensive experience with the financing of multi-family rental residential over the past 10 to 30 years, although some are currently involved with other activities. A few respondents had been builders previously and some had been or still were owners or worked for companies which are owners or managers.

The uniformity of responses among the 22 respondents suggests that on the main points their opinions and experience are representative of that part of the financial community which had been involved with residential rental accommodation. Respondents were asked for the names of colleagues who would have different opinions but could provide none. There is, however, no statistical basis for inferring the representativeness of the sample.

Each interview was conducted with the understanding that the responses would be used in this report, but that nothing said during the interview would be attributed to the respondent. The interviews focused on the opinions and experiences of the respondents and not of the organizations of which they were members at the time of the interview. Interviews lasted between 50 and 75 minutes.

1.2 THE SCOPE OF THIS REPORT

This report summarizes the respondents' experience, views and opinions on various aspects of the financing of multi-family rental accommodation, and how they perceive lending to be affected by the present rent review legislation and proposed changes. The interview schedule can be found in Appendix 1.

At the time of the interviews the Liberal and New Democratic Parties' agreement on universal rent control was a matter of public record. The policy was not implemented until after the interviews were completed.

Respondents often use "rent control" as a synonym for rent review and we have followed that practice where appropriate to the context.

All respondents stated that, for reasons at least partly related to rent review, they had not been heavily involved with lending for multi-unit rental accommodation for some years and, consequently, we did not solicit their opinions on specific regulations and practices of the rent review system.

All quotations appearing in this report were made by respondents during the interviews.

2.0 MAJOR FINDINGS

Respondents voiced similar opinions on all major points relating to rent review. There were some differences on various matters, but these differences were not considerable and do not detract from the overall consensus.

The following is a summary of the major points made by the respondents.

1. **Lenders**

There are, essentially, two types of loans associated with residential rental: bridge financing for new construction to cover the period of development, including all or some of the construction phase; and long-term financing, typically in the form of mortgages.

The bridge lender tends to be concerned with whether the builder can meet the requirements of the long-term lender.

> "...all it takes to get their development financing from the banks is a take-out letter for permanent financing. Over the past decade or longer, a whole industry has developed around providing take-out financing, and taking fees for the issuing of these, without any expectation that the developer would ever be able to to make those dreams come true."

The long-term lender is involved with financing new construction and refinancing or re-mortgaging existing buildings. In the 1960's and early '70s, if the mortgage was insured under the National Housing Act (NHA), lenders would lend up to 90% of the appraised value of building. In the case of new buildings, the value would be based upon estimated construction costs. More recently, the value of

loans has been reduced to 75% or less of the estimated value of the building.

The value of the building is calculated on the basis of income. The lender looks for reasonable assurance that the income generated by the new or existing rental units will be sufficient to pay the operating costs of the building, the debt service and leave a cushion to cover unforeseen expenses and provide a reasonable return on investment to the builder or owner.

In the '60s and early '70s, the heyday of apartment construction in Ontario, lenders also took into account the quality of the builder, not only his size but also his judgement and track record.

> "We were one of the major lenders .... you wanted to deal with developers who knew what they were doing. Not necessarily larger developers, but people with a track record and a demonstration of good qualitative judgement. Scale is not necessarily the measure, but an individual who has good qualitative judgement both in terms of selection of a site and his track record over time as a property manager."

2. An Historical Overview

By the mid-1970's, and prior to rent review, apartment costs had risen at a rate higher than revenues because of such factors as inflation and new methods of apartment construction. The market began to deteriorate as costs exceeded revenues.

Several of the lenders argue that government actions, such as the speculation tax and rental assistance programs, distorted the market and made matters worse. Several others

say that owners, buyers and builders had inflationary expectations: buildings were being built or bought at inflated prices with the assumption that a return on investment (ROI) could be obtained through future inflation. Lenders were more cautious.

Whatever the causes, the owners and builders found their ROI was dropping dramatically. Rents were increased substantially as owners brought revenues into line with costs, there were tenant protests and the government responded by instituting the system of rent review.

Rent review was instituted at the time that a large number of new units were already under construction in response to the rent increases. This new volume, if it had been sustained, would have led to a levelling off of rent increases even if rent review had not been established, because there would have been a continuing supply of new units coming onto the market every year.

3. Effects Of Rent Review

Rent review has had a number of effects on builders and owners and upon the willingness and ability of lenders to participate in the market. The effects are closely related to each other and are set out below without regard to possible order of importance.

3.1 Both owners and builders were squeezed badly between the new system of rent review on the one hand and the worst inflation in memory on the other.

3.2 The large stock of existing rent controlled units deflated the rents which could be charged for new units. The necessary relationship between the costs of construction and expected income deteriorated, except in the luxury apartment category.

3.3 Similarly, the stock of rent controlled units had a deflating effect upon the rents which could be obtained from uncontrolled units, particularly outside Toronto where there was a smaller market for high rent units.

> "... and those projects that are under rent control deflate the entire market. The non-rent controlled markets cannot raise their rates too much or there becomes too much of a gap between them and the controlled buildings. So the controlled buildings artificially keep the other ones down."

3.4 The effect is to lower the value of buildings with controlled units and, to a lesser extent, of buildings with uncontrolled units.

> "Look at the Cadillac-Fairview sale and what they sold for per unit. Nothing. Why? Only because of rent controls ..... the basic premise of those sales was that they had dropped from $40,000 per suite to $25,000. New suites are costing $60,000 and they are not selling for that because of rent controls."

3.5 Although revenues are controlled,expenses are not. Lenders have no way of knowing what rent increases will be permitted above the allowed percentage to meet increased interest rates or operating and maintenance costs, or whether the allowed percent will be changed again; from 8% at the outset to 6% and, during the study period, to 4%.

Consequently, in qualifying owners of existing buildings for refinancing or buyers for a new mortgage, lenders look to actual income and take a conservative position on income projections.

> "Capitalization of the income stream. What is in place, not what is projected to be in place in a couple of years. On refinancing, quite often you get into problems. They have sold an apartment building and they are calculating that they are going to have a 16% or 18% increase in rent because of the new building cost aspect. That does not help us because it may never materialize."

3.6 A number of builders left the market immediately after the institution of rent review and others followed over the coming years because they could not construct units at a cost which would be price competitive with controlled units.

> "Who in their right mind is going to build apartments? Bramalea built. Cadillac built. What are they doing now? Trying to buy Woodwards."

Lenders report they receive few applications for loans for new construction.

> "I cannot recall seeing an ordinary conventional [loan] application in the last couple of years."

3.7 The applications they do receive which are successful involve government subsidies.

> "The main requirement for an apartment to get built today is some sort of subsidy from government."

> "We have not seen any applications that I can recall of a pure developer wanting to put up rental accommodation .... without some support from some government or other .... We have just not seen such an application. They are just non-existent because a developer without support would not make any money. He is better off to put his money into a bank account and collect the interest."

3.8 Because of the competition from controlled units, new units often have trouble being competitive even with government subsidies and NHA insurance. Extended periods of negative cash flow can cause the borrower to default, leaving the lender exposed on rate and term.

> "I have seen proposals laid on my desk which proposed negative cash flows for a period of years even with interest-free second mortgages from the government."

> "We are not going to invest our money in something that appears that it is going to lose money from day one."

Lenders also have to consider whether, in the face of competition from controlled units, new units can raise their rents sufficiently over the mortgage term to keep up with costs.

> "With a subsidy it [new construction] can work, but only until the fifteen years go by. That is the day of reckoning. That second mortgage comes due. And then you are going to have to repay that mortgage, and you are going to need economic rents to do it."

3.9 Lenders, therefore, tend to favour larger builders who have the resources to weather unforeseen costs, and to turn down smaller builders who may be good but lack substantial resources.

> "Track record and equity on the balance sheet are far more important than they ever were .... And that's not necessarily good. There are a lot of small developers who can probably do as good a job as any of the players in the market place."

3.10 The result is a substantial drop in loans for units for lower and middle income households.

> "Prior to 1975, we use to see a lot of the smaller walk-up type of apartment built by the individual investor as a retirement fund. And we would see them,

as they built up equity in one building, start another. That no longer happens because the replacement cost is far in excess of the earning capacity. So we do not see that type of apartment being built which was really a very good basic accommodation for the lower to middle income person."

3.11 The effects of rent review discriminate in favour of owners who run up high costs, including debt service, and against those owners who manage their properties carefully to keep costs down and pay off their mortgages.

"... if you own the building, and you have saved for years and years to make your mortgage payments out of other income to reduce your debt, as so many of these smaller apartment owners have done, you are penalized."

3.12 Similarly, rent review reduces the ability of the owner to borrow funds for maintenance, and the buildings deteriorate. The problem used to be more acute amongst smaller owners, but larger owners, including lenders, are also being affected.

"You can split the market into two. The buildings owned by financial institutions like ourselves, or the major developers, who have a long range view; and, the smaller operations, almost like a family operation with the walk-ups. They are an important sector. And they are getting hit to the point that they have to patch a roof that needs to be replaced. They cannot absorb the losses in their other holdings. They do not have other holdings. There comes a point when our own maintenance will deteriorate even if we can hold on longer than the Ma and Pa building."

3.13 Because of uncertainty created by rent review, lenders no longer regard the financing of new rental construction, or the refinancing of existing rental units, as the major source of business it once was. Some lenders have withdrawn almost entirely from the market.

> "Twenty years ago, apartments were our biggest source of business. Today they are a very small part of our business. In Ontario, less than 5% of our business today is in apartment buildings, and most of that would be re-financing. I do not think we have financed a new apartment building for years and years. There are not any to finance except those that have gone under a subsidy program."

Successful conventional loan applications typically involve luxury rental.

> "What little rental might make sense is going to be in the luxury range, and there are proposals now to bring that under rent control."

4. The Continuation of Rent Review

4.1 The continuation of rent review, as it was constituted during the summer of 1985, would contribute to the increasing scarcity of rental accommodation.

> "Under rent control, the long term prospects are a continuing contraction of supply without very strong government initiatives. That's proven and given .... An aging housing stock raises the question, 'Where will the stock come from to adequately house these people.'"

> "The drop in increase [from 6% to 4%] could significantly worsen the already depressed market, especially for buildings which are already encumbered by a mortgage; which is probably about three-quarters of the existing stock, in my own estimate."

4.2 Lenders would not be able to provide any funds for new construction and limited funds for refinancing.

> "As long as apartments are under rent control, the cash flow, expenses, and other factors which bankers necessarily consider will mean that apartment buildings will have a very limited ability to support the cost of the investment needed for construction. It will be harder to justify as complete coverage on the financing of new buildings. There will be some re-financing of existing buildings."

> "We are looking for the long run, and if they [owners of new apartments] have to sell out a few years down

the road to recoup their losses, then we do not have the investment that we thought we had ... It just does not make sense to launch into a venture that is guaranteeing losses ... You can see why, if an apartment building proposal lands on my desk along with a proposal for the same investment in an office building or a shopping centre or a retail building, what I am going to choose."

4.3 Several lenders said that the government would have to provide the housing.

> "I do not foresee much opportunity, from the discussions I have had with Toronto home builders and other people, for free market forces to go into providing rental accommodation. It does not make economic sense. They are better off to get their property rezoned and build houses."

> "There will be demands on government to provide more and more subsidized housing at a higher per unit cost."

5. Universal Rent Review

5.1 The establishment of universal rent review would make matters worse than they already were with respect to new construction and standards of maintenance in existing units.

> "I think that we would have absolute disaster. You would be down to no construction and no vacancy and all kinds of pressure."

> "The universalization of rent control will further slow down or completely disappear the market."

> "In the long run, the stock of rental housing is going to run down. Nothing is being built, and nothing is being improved. And, if you were a landlord, what would you do?"

5.2 The universalization of rent review would persuade owners of existing stock that there was no possibility of escaping rent control,and thereby encourage them to convert their stock to other, more profitable uses or to let the stock deteriorate to minimum standards.

5.3 Universalization favours the established middle class tenant and discriminates against the poor who need accommodation.

> "At least half the people who are benefiting from rent control can well afford the going rate. So you are subsidizing the people who are not in need. It is so inequitable, that is the problem. Even without a career advance, if you look at the inflation rate from '74 to '78, and the rate at which salaries advanced during that period, when rents did not go up at the same rate. The average tenant is not going to give you comparable numbers from this same period, but at least fifty percent of the tenants out there have to be really in the clover, benefitting from rent control."

> "The problem with universal rent control is that it really makes no sense. Rent control was meant to protect people who could not protect themselves. But people who are paying $1,000 a month do not need protection. It's contrary to natural economic law. If you want to put price controls on lettuce, so be it. But why put it on caviar? It's really irrational."

5.4 Part of the market depends upon psychological factors, the belief by the builder, the owner and the lender that things will get better.

> "But, the number of .... natural optimists are continually being reduced .... you really have to be perverse to believe that it will turn out better in apartments."

6. Improving the Situation

This subject generated the greatest diversity of opinion; although it may be that respondents were saying the same thing in different ways.

6.1 Lenders believe there is a need for rental housing and are willing to provide the long-term funding.

> "The Government is faced with a 'damned if you do, and damned if you don't dilemma.' No political party wants to let rents go up, and on the other hand, if they do not do something about it, I do not see how they will

> get anyone to build apartment buildings. As lenders, we are willing. We view that the need is there. It is not being fulfilled because it is not profitable for the builders to build it."

6.2 Several related issues need to be addressed in order to bring lenders, and builders, back into the market: the very presence of rent controls, trust, arbitrariness and the relationship of revenues to costs.

6.3 The very presence of rent controls has an unsettling effect upon the market.

> "But as long as you have that rental ceiling there, you are going to have a nervous market."

6.4 The government is the silent partner in residential rental, and alters rent increases without reference to the industry. Therefore, an increase in allowable rent increases would not, by itself, deal with the problem of long-term government behaviour.

> "If the rate were to increase to 8% or 9%, all that is going to do is to create a higher degree of equity for the owner, and maybe get a little better standard of maintenance. But it is not going to attract the person who would build a new building, because there is no assurance that this 8% will not be dropped to 4% at some future date."

> "The 6% is a capricious number. Once you are in the system, you are subject to the silent partner. But, I do not think the majority of developers will be taken in by the prospect of a higher percentage, if that percentage can be altered by arbitrary government decisions from year to year."

6.5 The government has not kept its earlier promises to the industry about rent review. The industry would require contractual agreements before it would trust the government again.

"Apartment buildings built after '76 are now going to go under rent control as well. This is a breaking of faith with the industry. And even if the industry was told today, 'You are not going to go under rent control', they would not believe it any more. If you cannot trust the government's undertaking, then you have a threat, and I do not think that any government undertaking that is not in the form of contract in future will be accepted ..... We have to look at 15-year mortgages with an assurance that we can take in an economic rent for each of those years. We cannot operate in an on-again, off-again way."

"....the position of the government was that buildings built after 1976 would not be subject to rent controls. Our company, for one, said there is no form of contract that will protect us.. Others believed the government and did some building. Well, events now have indicated that .... we were right not to have built anything after 1974."

6.6 A number of options were suggested. All of them had three aspects in common. The first was that the arrangement confirm the relationship between rent increases and costs so as to provide a sufficient incentive to bring builders back into the market and enable them to meet the lenders' criteria. The second was that the arrangement be long-term. The third was some form of guarantee from or contract with the government which would bind it to the agreed-upon terms.

"... Unless, it were tied to a contractual program which said, We will raise rents by 8% per annum until the vacancy rate goes to 3%, or 2.5% and then we will get out of rent control. Unless there is some mechanism for ensuring that that is going to happen then I say that it will not impact on new construction significantly."

"The mere presence of controls is the significant factor. But the other thing to look at is the relationship to the rate of inflation. Right now we have a rate of inflation of about 4%,so if you were to leave it [allowable rent increases] at 6%,what you would find, if inflation stayed low, is that you would

have a gradually self-correcting situation .... controlled rents would start getting close to market rents, and you could start to think of taking that ceiling off."

"If we believe that we are going to continue into an environment of further disinflation with 8.5% mortgage rates then a 4% rent increase might be manageable. But, as a general rule, the problem is not the availability of funding, but the ability of the borrower to service the debt. And that is always going to be a constraint. We are operating off a 30% to 40% gap."

Without arrangements of this type, lenders - and builders - are unlikely to re-enter the residential rental market to any significant extent, and those still in the market are likely to find it less attractive than before.

"The essence of real estate is that it has to be flexible enough to forgive your mistakes. If you get enough return out of it, you can cover off your contingencies. If you come into a system where your returns are fixed, then there is no tolerance. If you have a system that will adjust to the market more frequently, where real rates are higher than permitted rates, then I can have a mistake in my building and pick it up as I go along. You may not turn a profit until three years instead of a year or two because of that mistake. But, you can still remain confident of recovery. If my profits are very precisely defined by ceilings on my income streams, then if I make one mistake I can never pick it up."

3.0 FINDINGS

The following sections contain our findings. Except for the section on historical data, all the findings are based solely upon the interviews.

3.1 HISTORICAL DATA

A review of the published data on lending and construction for multi-family rental accommodation over the past several decades. Published information is provided as a neutral context within which the statements of respondents can be read.

Table 1 and Figure 1 summarize long-term patterns in NHA-insured and conventional loans for new multiple dwelling units from 1962 to 1984. (These patterns can be related to conventional interest rates 1970-84, Table 3).

The figures in Table 1 also include new condominium, cooperative and non-profit, socially assisted and subsidized and private rental units. Consequently, the figures should not be read as referring only to multiple-unit rental. Official figures for NHA loans for condominiums are set out in Table 7. We understand, however, that it is difficult to be precise about the final tenure of new multiple unit residential; some of the rental units are converted to condominium and some of the condominium units remain in the rental sector for varying periods of time. Time series data such as this can obscure significant events which impact upon trends. With this caveat we note that in 1962, when Ontario had a population of about 6.35 million persons, approximately 22,366 new multiple units were constructed. Subsequent years almost a cyclical pattern marked

by several years of growth, several years of diminished supply, then more years of growth followed by diminished supply. The overall pattern is, however, one of growth.

Supply peaked at almost 53,000 in 1973, fell back to almost 23,000 in 1974, and then rose sharply in the subsequent years. A new high of more than 48,000 was reached in 1977 before supply entered into a continuing decline. In 1984, with the population about 9 million persons, about 13,400 new multiple dwelling units were constructed, including condominiums, cooperatives, non-profit, socially assisted, subsidized and private rental.

Lenders stated that the high levels of supply in 1975-77 were the result of heavy market demand and high rent increases in the previous years. A large share of the new supply did not move through the pipeline to completion until after rent control was put in place.

The relatively high level of supply in 1983 includes a significant amount of housing subsidized under the Canadian Rental Supply Plan which has since been phased out.

In the early years, conventional loans represented about two-thirds of all loans for new multiple-unit residential construction and NHA-insured loans about one-third. Throughout the '60s, these proportions began to shift so that by the early '70s, NHA loans represented about two-thirds to three-quarters of all loans for new multiple-unit residential construction. Those proportions have remained the same throughout the '70s and '80s.

Table 2 sets out the composition of privately initiated apartment completions since 1973. There has been a sharp decline in all categories. The category of apartment buildings with more than 200 units has decreased the least, 36%; and buildings with 6 - 19 units show the second lowest decrease, only 45%.

Table 3 sets out the term structure of NHA-insured mortgages from 1970 to 1984. The major proportion of mortgages have consistently been for a term of 10 years or less. In some years - 1975 to 1978 - about 20% of mortgages had terms of 15 years or more. Mortgages with terms of 20 years or more disappeared after 1979.

Conventional mortgage rates show a steady climb from 1962 onwards, increasing from about 7.0% to 10.5% in 1970. There was a drop to 9.2% by 1972, and then a sharp increase to 11.2% in 1974 and 11.8% in 1978. After a one-point drop for two years, mortgage rates climbed sharply to 18% by 1981.

During this period, as Table 3 shows, real interest rates (i.e. the difference between the nominal rate and inflation) fell sharply from 6.9% in 1962 to about 0.5% in 1974 and 1975. This suggests that lenders were very badly squeezed by the mid-`70s, essentially lending money out at the same rate they paid for it and having little margin for costs, risks or profit. Since then, the real mortgage rate has increased steadily, with some fluctuations, to about 7.1% in 1983: figures for 1984 are not available. Lenders report, however, that the real rates are

still high, reflecting lenders' concerns about the potential for another bout of inflation.

Tables 4, 5 and 6 set out the distribution from 1977 to 1984 of NHA and conventional mortgage loans for new residential multiple dwelling units among the four major lenders: banks, life insurance companies, trust companies and private and other lenders. See also Figure 2.

The data indicate there have been major shifts in market share among the lenders with respect to NHA mortgages, conventional mortgages and total market. Private lenders have almost tripled their market share of NHA mortgages since 1977 and trust companies hold about the same market share. Banks now write very few NHA loans. Conversely, the banks have almost doubled their share of conventional mortgages, as have private lenders. These shifts have taken place in a shrinking market, as we noted above. Thus, although private lenders tripled their market share between 1977 and 1984, they financed 2,000 fewer units in the latter year than in the former. Overall, trust companies and private lenders are almost tied for first place, each financing somewhat less than 5,000 units (including condominiums) in 1984. Life insurance companies have fallen from a strong second place market share in 1977 to a weak third in 1984, slightly ahead of the banks.

Figure 3 summarizes rents for Ontario between 1961 and 1981 in current and constant (1981) dollars. The constant dollar line indicates that real rents dropped by 10% between 1971 and 1981.

Tables 8, 9 and 10 summarize the results of CMHC surveys on rent increases among samples of controlled and uncontrolled rental units in the 10 census metropolitan areas (CMAs) for the years 1981/82, 1982/83, and 1983/84.

The data suggest that each CMA has its own characteristics. For 1981/82, in all CMAs, rent increases were proportionately higher among uncontrolled units than among controlled units. In 1982/83 and 1983/84, the picture is more diverse. In almost half the CMAs, rental increases among controlled units were proportionately higher than among uncontrolled units, or about the same.

Table 11 summarizes provincial data concerning applications from landlords to the Residential Tenancy Commission for rent increases. There are considerable variations from year to year in the number of units involved in such applications, although the trend seems to be upward.

3.1a FIGURES AND TABLES

FIGURE 1

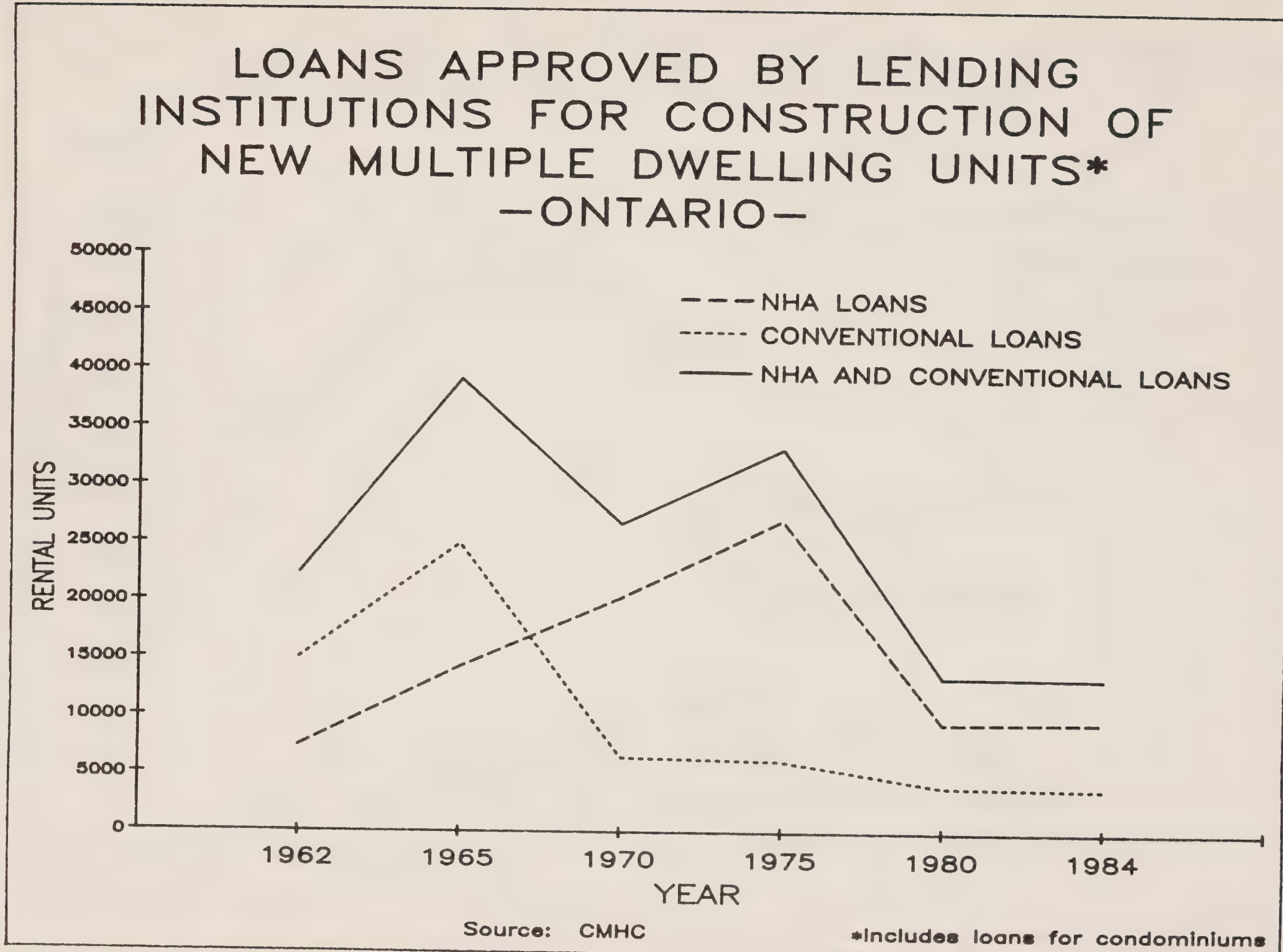
LOANS APPROVED BY LENDING INSTITUTIONS FOR CONSTRUCTION OF NEW MULTIPLE DWELLING UNITS*
—ONTARIO—
NHA LOANS
CONVENTIONAL LOANS
NHA AND CONVENTIONAL LOANS
RENTAL UNITS
50000
45000
40000
35000
30000
25000
20000
15000
10000
5000
0
1962
1965
1970
1975
1980
1984
YEAR
Source: CMHC
*Includes loans for condominiums

FIGURE 2

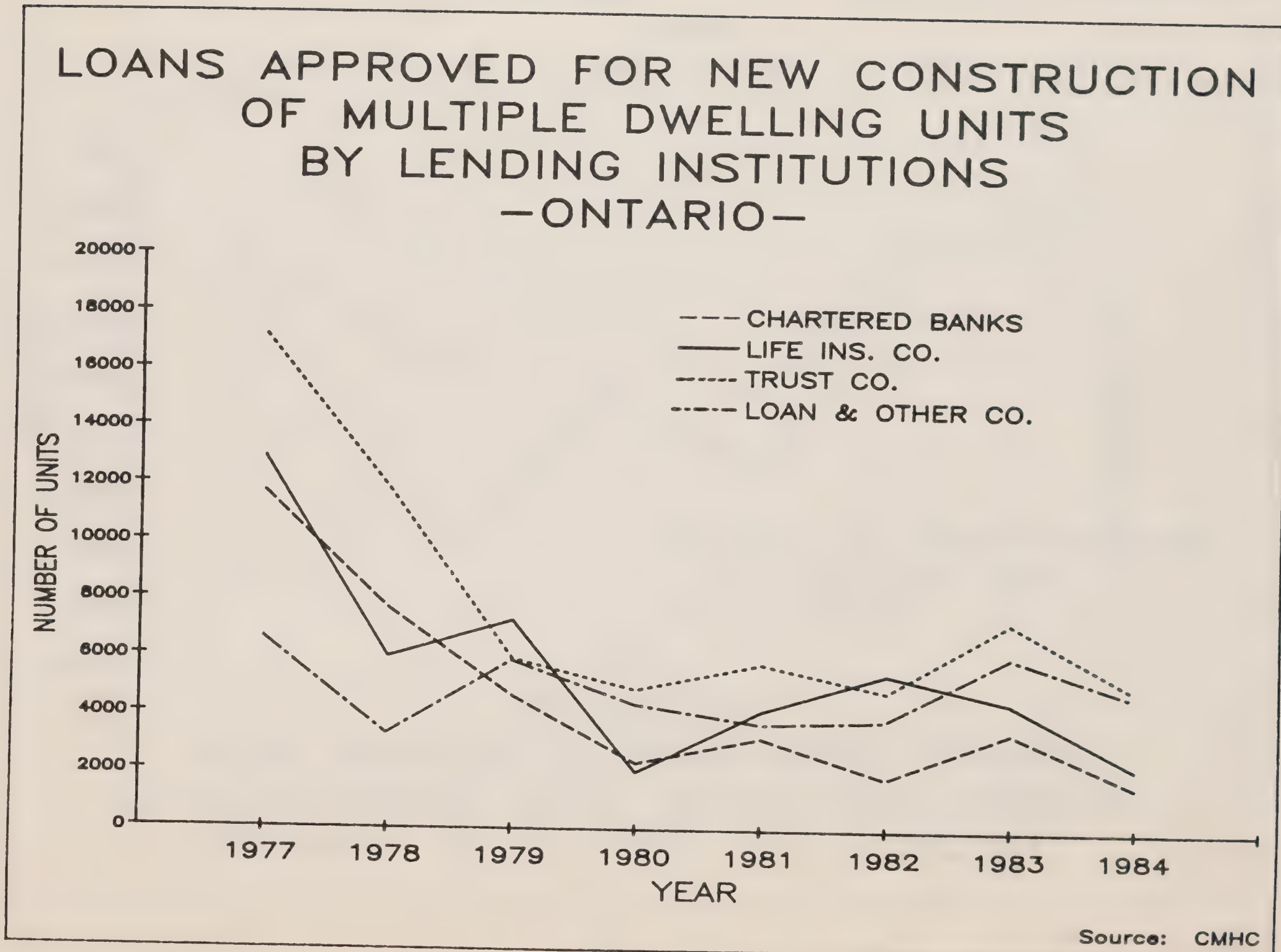
LOANS APPROVED FOR NEW CONSTRUCTION
OF MULTIPLE DWELLING UNITS
BY LENDING INSTITUTIONS
—ONTARIO—
CHARTERED BANKS
LIFE INS. CO.
TRUST CO.
LOAN & OTHER CO.
NUMBER OF UNITS
20000
18000
16000
14000
12000
10000
8000
6000
4000
2000
0
1977
1978
1979
1980
1981
1982
1983
1984
YEAR
Source: CMHC

FIGURE 3

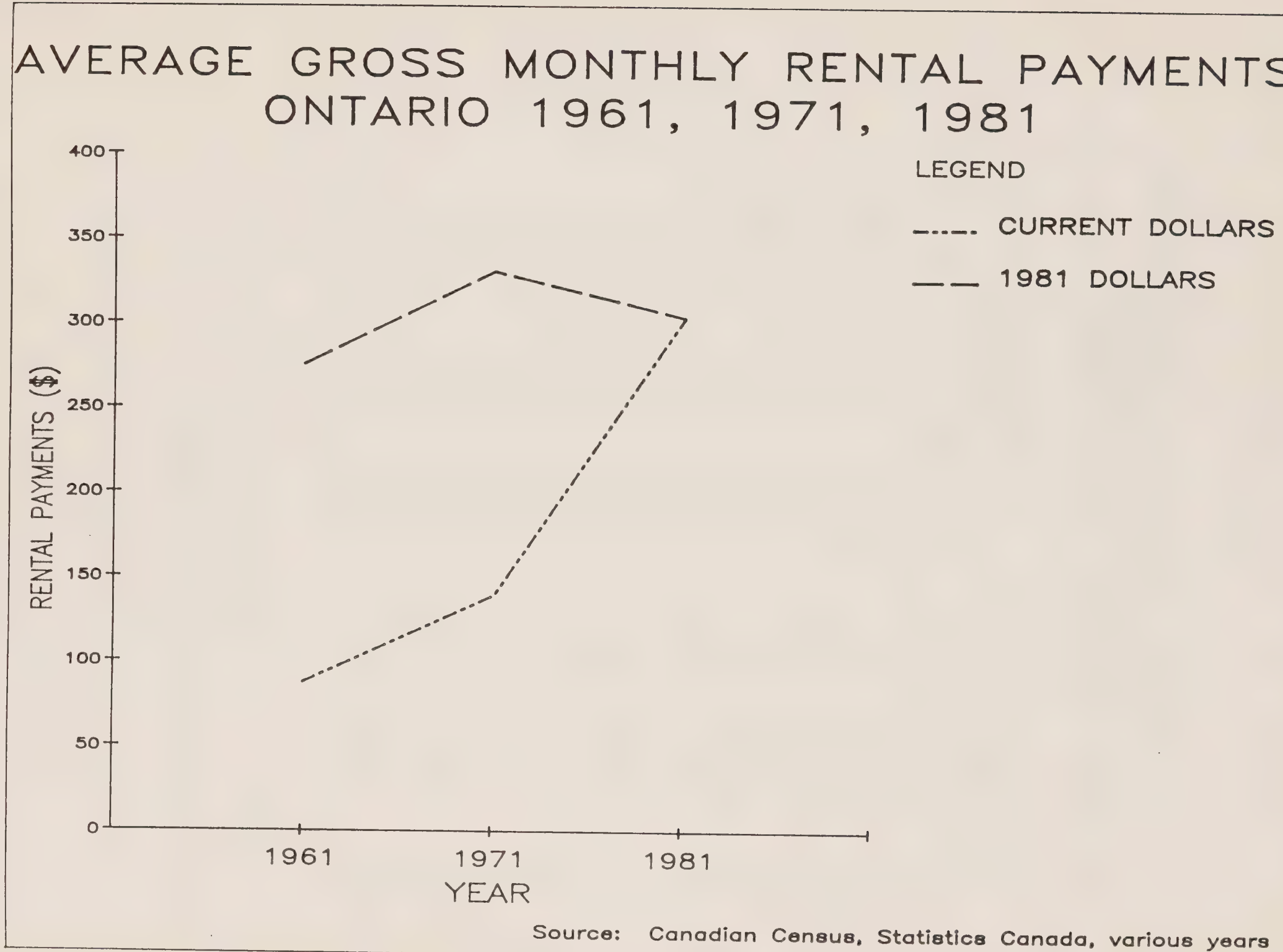
AVERAGE GROSS MONTHLY RENTAL PAYMENTS
ONTARIO 1961, 1971, 1981
LEGEND
CURRENT DOLLARS
1981 DOLLARS
RENTAL PAYMENTS ($)
400
350
300
250
200
150
100
50
0
1961
1971
1981
YEAR
Source: Canadian Census, Statistics Canada, various years

TABLE 1

NHA AND CONVENTIONAL MORTGAGE LOANS APPROVED BY LENDING INSTITUTIONS FOR NEW RESIDENTIAL CONSTRUCTION - MULTIPLE DWELLING UNITS, ONTARIO [1]

YEAR	NHA	%	CONVENTIONAL	%	TOTAL (100%)
1962	7,377	33 %	14,989	67 %	22,366
1963	8,038	29	19,816	71	27,854
1964	13,804	35	25,191	65	38,995
1965	14,254	36	24,896	64	39,150
1966	9,410	48	10,055	52	19,465
1967	17,054	50	16,835	50	33,889
1968	24,662	59	16,819	41	41,481
1969	17,889	55	14,587	45	32,476
1970	20,240	76	6,456	24	26,696
1971	33,038	75	11,299	25	44,337
1972	35,289	74	12,626	26	47,915
1973	34,102	64	18,848	36	52,950
1974	11,876	52	10,984	48	22,860
1975	27,055	81	6,148	19	33,203
1976	29,402	84	5,704	16	35,106
1977	39,587	82	8,744	18	48,331
1978	22,389	78	6,308	22	28,697
1979	16,251	69	7,333	31	23,584
1980	9,484	70	3,976	30	13,460
1981	12,595	75	4,162	25	16,757
1982	10,870	68	5,015	32	15,885
1983	16,987	80	4,159	20	21,146
1984	9,577	71	3,822	29	13,399

1 Includes loans for condominiums

Source: Canada Mortgage and Housing Corp.

TABLE 2

PRIVATELY INITIATED RENTAL APARTMENT COMPLETIONS
BY SIZE OF STRUCTURE - ONTARIO

	NUMBER OF STRUCTURES					TOTAL	TOTAL NUMBER OF
YEAR	<6	6-19	20-49	50-199	200+	STRUCTURES	DWELLING UNITS
1973	62	75	73	124	22	356	22,737
1974	54	61	71	120	59	365	34,029
1975	26	25	12	59	24	146	14,146
1976	24	29	22	39	15	129	10,993
1977	32	20	29	41	13	135	9,083
1978	21	29	30	56	16	152	11,794
1979	24	26	36	53	38	177	16,635
1980	12	12	24	41	21	110	10,873
1981	11	7	13	12	7	50	3,908
1982	13	7	24	22	6	72	5,052
1983	19	20	24	31	9	103	6,612
1984	22	41	20	28	14	125	8,547

Source: CMHC

TABLE 3

INTEREST RATES AND NHA LOANS APPROVED BY 'TERM' FOR NEW MARKET HOUSING FOR RENTAL APARTMENTS IN ONTARIO

In Number of Units

Year	UNITS BY TERM											
	1-5 Years		6-10 Years		15 Years		20 Years		25+ Years		Mortgage Rates[1]	
	No.	%	No.	%	No.	%	No.	%	No.	%	Nominal	Real
1970	47,473	88%	3,627	7%	118	-	534	1%	1,937	4%	10.5%	6.9%
1071	58,885	87%	4,243	6%	908	1%	1,438	2%	2,527	4%	9.4%	6.3%
1972	50,351	79%	5,213	8%	852	1%	3,005	5%	4,060	7%	9.2%	4.3%
1973	39,508	77%	4,220	8%	1,194	2%	2,132	4%	4,558	9%	9.6%	1.8%
1974	17,372	92%	67	-	152	1%	152	1%	1,187	6%	11.2%	0.3%
1975	29,636	76%	2,397	6%	3,693	10%	999	3%	1,831	5%	11.4%	0.6%
1976	17,816	61%	5,259	18%	3,744	13%	338	1%	2,057	7%	11.8%	4.0%
1977	30,562	53%	16,160	28%	6,453	11%	310	1%	4,129	7%	10.4%	2.2%
1978	12,426	52%	6,058	26%	3,273	14%	234	1%	1,595	7%	10.6%	1.6%
1979	13,487	69%	3,934	20%	1,285	7%	161	1%	633	3%	12.0%	2.5%
1980	5,919	82%	364	5%	844	12%	-	-	96	1%	14.3%	3.8%
1981	8,630	82%	1,730	17%	94	1%	-	-	-	-	18.2%	5.0%
1982	6,825	75%	1,327	14%	1,052	11%	-	-	-	-	17.9%	6.4%
1983	13,872	82%	2,314	14%	1,052	4%	-	-	-	-	13.3%	7.1%
1984	6,148	84%	1,133	16%	-	-	-	-	-	-	11.0 - 15.0[2]	NA

Source: CMHC

1 Source - Bank of Canada, in J. Pringle, Ontario Residential Tenancies: A Statistical Profile, 1985, unpublished

2 Rates are minimum and maximum for one and five year terms combined, Source - CMHC

TABLE 4

NHA MORTGAGE LOANS APPROVED FOR NEW CONSTRUCTION
OF MULTIPLE DWELLING UNITS BY LENDING INSTITUTIONS - ONTARIO

YEAR	CHARTERED BANKS		LIFE INS. CO.		TRUST CO.		LOAN & OTHER CO.		TOTAL	
	#	%	#	%	#	%	#	%	#	%
1977	10,759	27%	9,924	25%	13,547	34%	5,357	14%	39,587	100%
1978	6,605	30	4,619	21	8,704	38	2,461	11	22,389	100
1979	3,050	19	5,258	32	3,669	23	4,274	26	16,251	100
1980	1,648	18	1,058	11	3,693	39	3,085	32	9,484	100
1981	2,531	20	2,009	16	5,063	40	2,992	24	12,595	100
1982	1,078	10	3,486	32	3,565	33	2,741	25	10,870	100
1983	2,247	13	3,612	21	6,204	37	4,924	29	16,987	100
1984	763	8	1,584	17	3,668	38	3,562	37	9,577	100

Source: CMCH

TABLE 5

CONVENTIONAL MORTGAGE LOANS APPROVED FOR NEW CONSTRUCTION
OF MULTIPLE DWELLING UNITS BY LENDING INSTITUTIONS - ONTARIO

	CHARTERED BANKS		LIFE INS. CO.		TRUST CO.		LOAN & OTHER CO.		TOTAL	
YEAR	#	%	#	%	#	%	#	%	#	%
1977	941	11 %	2,964	34 %	3,585	41%	1,254	14 %	8,744	100 %
1978	1,032	16	1,345	22	3,117	49	814	13	6,308	100
1979	1,584	22	1,975	27	2,202	30	1,572	21	7,333	100
1980	654	16	937	24	1,145	29	1,240	31	3,976	100
1981	665	16	2,119	51	690	17	668	16	4,162	100
1982	751	15	1,938	39	1,249	25	1,077	21	5,015	100
1983	1,190	29	831	20	1,011	24	1,127	27	4,159	100
1984	813	21	627	17	1,262	33	1,120	29	3,822	100

Source: CMHC

TABLE 6

NHA & CONVENTIONAL MORTGAGE LOANS APPROVED FOR NEW CONSTRUCTION OF MULTIPLE DWELLING UNITS BY LENDING INSTITUTIONS - ONTARIO

	CHARTERED BANKS		LIFE INS. CO.		TRUST CO.		LOAN & OTHER CO.		TOTAL	
YEAR	#	%	#	%	#	%	#	%	#	%
1977	11,700	24%	12,888	27%	17,132	35%	6,611	14%	48,331	100 %
1978	7,637	27	5,964	21	11,821	41	3,275	11	28,697	100
1979	4,634	20	7,233	31	5,871	25	5,846	24	23,584	100
1980	2,302	17	1,995	15	4,838	36	4,325	32	13,460	100
1981	3,196	19	4,128	25	5,753	34	3,680	22	16,757	100
1982	1,829	12	5,424	34	4,814	30	3,818	24	15,885	100
1983	3,437	16	4,443	21	7,215	34	6,051	29	21,146	100
1984	1,576	12	2,211	17	4,930	37	4,682	34	13,399	100

Source: CMHC

TABLE 7

NHA MORTGAGE LOANS APPROVED
FOR CONDOMINIUM TENURE
IN NUMBER OF DWELLING UNITS - ONTARIO

YEAR	NEW BUILDINGS		EXISTING BUILDINGS		TOTAL	
1970	6,928	(96%)	308	(4%)	7,236	(100%)
1971	4,935	(98%)	81	(2%)	5,016	(100%)
1972	4,481	(98%)	91	(2%)	4,572	(100%)
1973	10,949	(95%)	579	(5%)	11,528	(100%)
1974	7,600	(87%)	1,111	(13%)	8,711	(100%)
1975	16,895	(93%)	1,249	(7%)	18,144	(100%)
1976	17,750	(96%)	698	(4%)	18,448	(100%)
1977	12,472	(86%)	2,077	(14%)	14,549	(100%)
1978	2,938	(51%)	2,807	(49%)	5,745	(100%)
1979	1,191	(44%)	1,490	(56%)	2,681	(100%)
1980	867	(28%)	2,231	(72%)	3,098	(100%)
1981	494	(14%)	3,160	(86%)	3,654	(100%)
1982	386	(9%)	3,697	(91%)	4,083	(100%)
1983	839	(11%)	6,962	(89%)	7,801	(100%)
1984	1,019	(13%)	6,567	(87%)	7,586	(100%)

Source: CANADA MORTGAGE AND HOUSING CORPORATION

TABLE 8

AVERAGE RENT INCREASES
TWO-BEDROOM UNITS in
BUILDINGS OF 6 UNITS AND MORE

October 1982 vs October 1981

Census Metropolitan Area	All Units	Controlled	Uncontrolled
		% Change	% Change
Hamilton	8.6	8.3	10.6
Kitchener	10.2	9.8	12.1
London	10.0	8.8	12.7
Oshawa	13.6	11.7	18.9
Ottawa	10.0	8.2	17.8
St.Catharines/Niagara	13.1	12.1	17.0
Sudbury	10.1	7.0	18.4
Thunder Bay	7.7	7.3	8.1
Toronto	11.8	11.0	16.8
Windsor	4.6	3.9	6.1

Source: CMHC Survey October 1982

TABLE 9

AVERAGE RENT INCREASES
TWO-BEDROOM UNITS in
BUILDINGS OF 6 UNITS AND MORE

October 1983 vs October 1982

Census Metropolitan Area	All* Units	Controlled**	Uncontrolled**
		% Change	% Change
Hamilton		Not Available	
Kitchener	6.3	6.6	5.1
London	4.7	4.9	4.3
Oshawa	6.4	N/A	N/A
Ottawa	8.3	8.2	8.8
St.Catharines/Niagara	4.0	4.0	3.6
Sudbury	7.4	7.2	12.9
Thunder Bay	8.3	7.0	10.0
Toronto	6.2	6.3	5.8
Windsor	7.4	7.0	7.7

Source: CMHC Survey October 1983

* Published
**Unpublished

TABLE 10

AVERAGE RENT INCREASES
TWO-BEDROOM UNITS in
BUILDINGS OF 6 UNITS AND MORE

October 1984 vs October 1983

Census Metropolitan Area	All* Units	Controlled**	Uncontrolled**
		% Change	% Change
Hamilton	6.1	7.7	3.5
Kitchener	6.6	6.7	6.5
London	5.0	5.7	3.8
Oshawa	6.9	7.7	4.8
Ottawa	4.9	4.0	7.7
St.Catharines/Niagara	6.9	6.4	9.2
Sudbury	4.0	4.1	N/A
Thunder Bay	7.3	6.0	8.8
Toronto	5.5	5.4	5.7
Windsor	13.2	7.0	17.7

Source: CMHC Survey October 1984

* Published
**Unpublished

TABLE 11

RENT REVIEW SUMMARY AVERAGES
ONTARIO, 1976 - 1984

YEAR	UNITS DEALT WITH	MONTHLY INCREASE REQUESTED (%)	MONTHLY INCREASE REQUESTED ($)	MONTHLY INCREASE GRANTED (%)	MONTHLY INCREASE GRANTED ($)
1976	131,455	19.7	39.55	12.6	25.30
1977	39,219	18.4	39.52	12.5	26.85
1978	40,949	15.8	34.35	9.7	21.09
1979 (Part1)[1]	18,370	17.4	36.74	11.2	23.65
1979-80[1]	19,469	14.3	33.75	10.7	25.25
1980-81[1]	42,377	15.7	39.55	11.6	29.60
1981-82	82,651	19.3	54.04	14.7	41.16
1982-83	127,812	20.9	62.77	14.2	42.45
1983-84	106,472	19.7	63.38	10.6	33.91

Source: Annual Reports, Rent Review Program 1976 - 1979
Annual Report, Residential Tenancy Commission, 1979 - 1984

1 1979 is for January 1 to August 31; 1979-80 is for September 1, 1979 to March 31, 1980; later figures are for 12 month periods April to March 31

3.2 LENDERS AND FINANCING

There are two major stages of financing: bridge financing to cover the period of development and construction and long-term financing or mortgages.

3.2.1 Bridge Financing

Bridge financing consists of funds lent over the short-term to enable the developer to cover his costs for new construction until the permanent financing is in place. Typically, the borrower must fulfill certain requirements or covenants before the long-term lender will advance the funds which will 'take out' the bridge lender. Some bridge lenders, therefore, tend to be most concerned with whether the builder can meet these short-term requirements.

> "...all it takes to get their development financing from the banks is a take-out letter for permanent financing. Over the past decade or longer, a whole industry developed around providing take-out financing, and taking fees for the issuing of those, without any expectation that the developer would ever be able to make those dreams come true."

> "We were not the least bit interested in the cash flow. We were interested in the take-out. Could he get it up and turn it over, and meet all the commitments in the covenants attached that were required by the mortgage commitment that he had?"

> "...we would not go in without 25% up front, and a firm take-out. Those were the two vital requirements. And it is not too much changed today. This would apply equally to apartments as far as firm take-outs of 25%, and the landlord's equity. If there was a firm take-out then the rest was the concern of the mortgage company."

Bridge lenders said that in some cases they would lend funds before arrangements had been made for long-term financing. In these instances, the lender would be concerned with the quality of the project and would behave more like a conventional long-

term lender. One lender noted that if the

> "economics of the building could produce a viable cash flow which was sufficient to cover debt service to 1.1 on an NHA insured loan, and on an uninsured loan to 1.19 or 1.20"

this was commonly acceptable for bridge financing.

Other bridge lenders outlined other criteria which they would likely apply.

> "We would go out and check the rental situation in the area. I remember in 1965 apartments in Etobicoke being advertised with two months free rent. We used to take rental income as ten months rent instead of twelve. If we felt that the building was otherwise worth seven times gross, we took it as four times gross, and everybody was happy."

The lender would then apply the standard formulas for cost and coverage. "There was nothing special about apartment buildings. It was all basic to any apartment deal."

There was a widespread recollection that, as one major lender expressed it, "At that time, the supply of housing was in relatively good balance. It was actually quite a simple investment to underwrite."

Some bridge lenders also said that their involvement in the details of the project would depend upon the capabilities of the builder.

> "It would depend upon the capacity of the lender. If it was a small developer without much experience we would get much more involved in the nuts and bolts of the transaction. We might look at market surveys, rental projections and so on. But, with the experienced developer we did not really worry about those things. We looked to the capacity of the developer to complete. Usually, these [bridge] loans were with full recourse to his whole assets."

Most bridge financiers spoke of their activities in the past tense, saying they did little bridge lending today.

3.2.2 Long-Term Financing

Long-term lenders are involved with both new construction and the refinancing of existing buildings. They state they have maintained essentially the same lending criteria over the past decades. The long-term lender wants to ensure that the income generated by the rental units will be sufficient to cover operating costs, debt service, a cushion to absorb unexpected expenses or vacancies and provide a return of investment (ROI) to the developers.

3.2.2.1 Coverage

The concept of coverage was described as the formula the lender uses to determine the monthly payment the borrower can make. It is the ratio of the monthly income, less operating expenses, from the property to the monthly payment for the loan where the monthly payment is 1.

A respondent gave the following example of coverage. If a rental building throws off $22,500 a year in income after operating expenses, and the coverage is 1.5:1, the lender will lend an amount which requires payment of interest and principal totalling $15,000 a year. If coverage is fixed at 2.0:1, the lender will lend only an amount which requires payment totalling $11,250 a year. The higher the coverage the more money for financing the owner has to provide himself or from other sources.

"As a general rule you look for a coverage of 1.15 to 1.20, so if you know what the NOI [net operating income] is, calculate the loan to leave 15% to 20% over the gross income to give you sufficient for variances in the income stream over time. And, again, I say that 115% to 120% is an industry standard. If you are impressed with the quality of the balance sheet, or the quality of the real estate you might use a sharper pencil, and shave it downward. If you're dealing in a non-recourse situation that you define as average in the qualitative sense, then you would probably go for a higher deficit. What you're looking for is enough to cushion the margin of error in the event of shocks."

In the 1960's and early 70's mortgages on residential rental went as high as 85% to 90% of construction costs.

"An insured loan would go as high as 85% to 90%. We would be looking for coverage of 1.2. There were pretty standard guidelines which you could apply. The return on equity would be anywhere from 8% to 15%."

A major factor was the presence of National Housing Act (NHA) insurance and the security it offered the lender.

"If CMHC approved the NHA insurance, we lent the money. And 90% of the multi-family starts were NHA-insured prior to 1975. Sure, they wanted the 1.1 coverage. But what they really had was a piece of paper signed by the Queen. And the difference between 1.1 and 1.05 was $5 in rent. Who is to say what the building will rent for a year from now? Will it fetch $190 per month or $195 per month?"

More recently, lenders have reduced mortgages to about 75%, sometimes less, of the capitalized income of the building. One lender said:

"We are just a capitalization of an income stream: the total rent you are getting from the building, less a vacancy allowance, and then take off all your operating costs and you get your effective rent left over, and capitalize that as opposed to your mortgage rate, and that is your value. And 75% of that, providing we like the price, and we perceive that it can be rented."

Some lenders also stressed the abilities of the builder.

"We were one of the major lenders ..... you wanted to deal with developers who knew what they were doing. Not

necessarily larger developers, but people with a track record and a demonstration of good qualitative judgement. Scale is not necessarily the measure but an individual who has good qualitative judgement both in terms of selection of a site, and his track record over time as a property manager."

In summary. Bridge financing is to fund the builder until he has completed sufficient construction and otherwise met the covenants required by the long-term lender. Bridge lenders tend to be concerned with whether the builder can meet these covenants to take out the bridge financing. If the long-term lending is not yet in place, bridge lenders will look more closely at the long-term viability of the project.

Long-term lenders are involved with both new construction and refinancing of existing buildings. They want reasonable assurance that income generated by the rental units will be sufficient to cover all operating and debt service costs and leave an adequate cushion for unexpected expenses and a reasonable return on investment for the builder. A standard formula used by long-term lenders is coverage; the ratio of the income, less operating expenses, to the loan.

3.3 EFFECTS OF RENT REVIEW

3.3.1 The Years Prior to Rent Review

The financing of residential rent accommodation over the past 20 years and the extent to which it has changed: the bases upon which funds were lent prior to rent review, including coverage, market value, interest rates, return on investment, risk, liquidity; the reasons financing became more difficult in the 1970's.

Respondents noted that the effects of rent review have to be considered within the context of larger considerations. These include the growth in inflation, interest rates, and construction and operating costs over the past two or three decades.

These circumstances contributed to a dislocation in the residential market prior to the implementation of rent review. Rents and income fell behind costs. This reduced the

developer's return on investment on his existing stock and his ability to generate new stock.

3.3.1.1 A Chronology

The following are extended descriptions of these events by several respondents. Other respondents provided shorter but similar descriptions.

The first account is from a private lender.

> "Twenty years ago we had a relatively strong residential real estate market in Canada. There was no rent control. Major developers such as the Cadillacs, the Greenwins and many of the other developers could bring to the market medium, low and high rise buildings which were economically viable.
>
> "Twenty years ago, in 1965, was the heyday of apartment construction. At that time, we can recall a scenario in which an apartment building cost $10,000 a suite.
>
> "Let us assume that a landlord was able to rent these units for $150 a month, equal to $1800 a year. If the expenses of maintaining this unit were 45% of the revenue, that will leave available 55% of $1800 equal to $999 for financing.
>
> "On a $10,000 investment that will leave 9.9%, at a time when a landlord used to borrow at 7%. So, in the heyday of heydays, the owner was making almost three per cent. If he had had to invest only 10% of his own funds, he was seeing a 30% return on his own actual investment.
>
> "If a lender made a loan of a $9,000 mortgage on your $10,000 suite, at 7%, the interest would be $6300 and the principal would be the other $300. So, at that time a 90% mortgage was a feasible thing. And the builder was only having to find equity of ten per cent.
>
> "About fifteen years ago, the market began to get a bit tight. There began to be a bit of a squeeze play between the various economic factors during the five years prior to rent control. Inflation had started to rear its ugly head and impacting on the major costs of running an apartment building.
>
> "The Government introduced a number of measures to stimulate housing. Most of them were based on inflationary defenses which had a rather questionable acceptance by the lending institutions. The AHOP assistance, about 1973, basically

dictated that lending institutions would become involved. We look back and see the disastrous results, but we also have to remember the thousands of units which were brought into production."

The respondent then went on to 1975.

"Now, let's look at the situation a decade later, in 1975, an hour before rent control goes into effect.

"Construction costs had doubled by then, so that if we had an example of $10,000 before, we are now looking at $20,000 for construction.

"In our previous example, we had a rental of $150. But rent has not doubled. They have gone up 60% to $240 per month or $2,880 a year which we can round off to $3,000.

"Let's continue to assume expenses of 45% and a remainder of 55% for financing. That represents $1650 for financing when interest rates are up to 10%. We go back to the lender who says, "I'll lend you an amount whereby the charges are $1100 per year. I'll lend you $10,000."

"But the cost of construction is now $20,000. So we now have to put up 50% equity where we used to put up only 10%. Now somebody will build because they expect that not too many other people will build, and prices will rise. But basically, the market is deteriorating.

"But it was not that bad. Some people would have built at that rate. It's not that great a negative split."

The respondent then moved to 1985.

"Ten years later we've come through the worst inflation. The $20,000 construction cost has probably gone to $50,000. But rent, during this ten year period, has risen only to $500 per month, which equals $6,000 per year.

"If it was tough when interest rates were ten per cent, we're now looking at 12%. At the current rent of $500, we have $3,000 per suite. So, the lender can now lend you $15,000 per suite which means that the builder will have to put in 75% equity."

3.3.1.2 Government Programs

A private lender, who had been a builder, notes the importance of NHA insurance and other government programs.

"I grew up in the business of building rental accommodation.

The first building I built was in 1953. It was financed 90% by government funds, under what was then called a rental insurance program. The government advanced funds at a low interest rate, I think it was about 4.5% over forty years provided that the owner kept his rents fixed for that period of time. But fixed meant fixed as to operating costs. You had to have your rents approved by CMHC. And they were quite realistic in terms of appraisal of what the rent should be from year to year. These buildings turned out to be viable investments.

"While 90% of the funds came from the federal government, and 10% from the developer, in computing that 10%, they did allow half that 10% for overhead and profit so that the developer actually put out between 5% and 7%.

"You have to appreciate that the market for rental accommodation was not what it is today. You could not get land, you could not get material. It was a business that required a fair amount of entrepreneurial skills.

"While the rental insurance program took hold and provided a fair amount of pretty good accommodation for low and lower middle income people, it was virtually the only ball game in town. It was only in the early 50's that the private sector started financing apartment buildings out of conventional funds, or what they called insured NHA loans.

"That is how we got into the business. And we were able to make a small amount of money on it. We sold the first building and built up our equity that way.

"By 1962, our company owned 600 to 700 apartments. For a lot of reasons, we became very bullish on the market. And at one stage we had as much as 2,000 suites under construction in '62 or '63.

"By 1968, our company owned approximately 10,000 apartments, and were managing them. ... What happened in those years was that the traditional rate of return expected varied anywhere from 20% to 35% return on capital at cost. If you allowed for your time, overhead and profit, those returns might have dropped to 15% to 25%. That is the range of returns that we were getting from 1955 to 1968.

"This was the cash return on a cash basis, not on an income basis, which would have been much less because that would include depreciation, and replacement costs. This was the rate of return on your investment after paying your mortgage expenses.

"In other words, if you looked at a property, and you

figured you would get a conventional mortgage of 75% or an NHA-insured mortgage of 85% to 90%, on the balance of the funds, you would be expected to invest, you would expect to make something in the order of 25% to 30%. We covered our overhead by other things, and we never allocated an entrepreneurial profit to these buildings. So on a cash basis it came to a 25% range.

"Well, about 1968, when we owned about 10,000 or 11,000 apartments, we averaged an approximate return of 13% or 14%. Then, interest rates started to rise, and costs started to go up in an inflationary cycle, and we started to find our rate of return starting to drop fairly dramatically."

3.3.1.3 Market Deterioration

While respondents were agreed upon the general trend of events up to the time of rent control, they differed to some extent over details.

Some lenders thought that government action encouraged the deterioration in the market prior to the introduction of rent review. One lender emphasized the importance of the provincial speculation tax.

"I think it started originally with the speculation tax brought in by the provincial government on April 15, 1974. That is the date that hundreds of people dropped their offers to purchase condominiums. It was the beginning of the slump. These units had to be converted into rental units. It put a huge supply into the apartment side, and the market slumped. As soon as that supply was eaten up, a minority government came in and introduced rent control."

Another lender thought that the difficulties began with rental assistance programs.

"My perception, and I stopped doing apartment financing in the mid-70's, is that the market started to deteriorate as soon as the free market could not handle it. As soon as the first government program brought in, in 1975, the first rental assistance program, to bridge the gap between economic rents and market rents .....That was the first time that I saw people starting to back away from the market."

Some lenders thought that the market had overheated, that buyers

and owners were building inflationary expectations into their calculations, and taking lower short-term returns on investment in the expectation that inflating rents and inflating building prices would improve the long-term rates of return (selling the building at an appreciated value). This attitude made lenders very cautious.

> "Financing got hard because expenses were going up and sales of apartments took place at very, very high figures. Those sales figures would have meant almost a zero return. And a lender would look at it and say, 'This fellow wants to buy a building against future inflation, but I'm just a lender. So, we need to make sure we get paid even if inflation does not continue.'"

Whatever their view of events, respondents were agreed that by 1975 rents had fallen behind costs and that this was having a deleterious effect upon rates of return and the construction of new rental units. Rents were rising by significant amounts, in some cases 30%, and there were tenant demonstrations.

> "What got us into rent control was that tenants were getting rents that were not commensurate with the market place. Rents were starting to adjust in '73 and '74, and tenants protested and rent controls came in. All you have to do to confirm this is to take the annual statements of Cadillac-Fairview which are public documents and you will see the drop in return per dollar of investment from 1968 to 1974 in the balance sheets."

One respondent, speaking of the various factors, said:

> "There is a diversity of opinion of how much weight to attribute to each factor. The combination of inflation and price control squeezed the developer very, very severely to the point where it was not worth taking the risk of developing when he could not see the light at the end of the tunnel."

3.3.1.4 Market Improvement

A number of respondents said that the situation had already begun to stabilize by the time rent controls came in.

One lender, who had been active in the development industry, agreed that the decline in profitability became noticeable by 1970, and said this was regarded as a temporary phenomenon. Builders continued to build in the belief that rents would catch up with costs eventually.

> "I recall that in 1970, our rate of return dropped to about 8% to 9%. In 1971, they dropped again. But the developers of the day continued to build even though the rate of return continued to drop below the rate of return in other investments. The reason we kept building was an imbalance in the market place between rentals and costs, and that over time [we believed] an adjustment would take place."

Other lenders said that by 1974 rents had, in fact, begun to catch up with expenses.

> "When you had a high inflation rate and a high interest rate, finance theory would say that you should be prepared to operate for an extended period of time with a negative cash flow. In other words, you should be capitalizing the interest expense. But developers do not feel that comfortable about their ability to predict the future, nor do lenders, in a situation with a negative cash flow. As a result, the current returns required to make the investment viable were just not there.
>
> "In the normal course, if everybody believes that supply and demand will get into balance, then it never happens because everybody continues to build. But, in this business, because you need capital, undoubtedly rentals would have caught up. And, in fact, they started to catch up about 1974."

One of the lenders who had been a developer said that had he known about rent review he would not have build apartments.

> "And just at the point in time when rentals started to rise, rent controls are brought in. If our company had not built anything from '70 to '74, we would have been much richer. If we could have predicted that all these buildings would become rent controlled, we would have never built them. When rent control came in, we said, 'This is not a business we want to be in', and we stopped building rental apartments except for one or two projects we wanted to clean up."

In summary. In the 60's, a builder could invest 5% to 10% of the construction cost of the building and obtain financing for the rest; in some cases he could obtain financing for the entire cost. Cash on cash return on investment might be 30%. There was a close relationship between the costs of construction, operating expenses and rental income.

In the late 60's, early 70's, that relationship began to deteriorate because of inflation and the higher costs of new forms of apartment construction. Rents, which typically lag behind cost increases because of the lease structure, fell behind even further. Using the standard principles of coverage, a builder had to put in substantially higher percentages of equity. Returns on investment dropped substantially.

Lenders vary somewhat in their chronology of events. They are agreed, however, that by 1975 rents had fallen significantly behind inflation, that rent increases of up to 30% to restabilize the situation created tenant protest and that these protests led the provincial government to institute rent review. Rent review was instituted at the same time that market forces had already begun to rectify the situation.

3.3.2 New Construction and Rent Review

The effects of rent review upon new construction: inflation, costs and income; the temporary nature of rent review; competition with rental stock under rent review; the switch to subsidised construction; the inadequacies of NHA insurance and subsidies; lending to the large and the small builder.

The decade which followed the introduction of rent review was marked by increasing rates of inflation, rates which were beyond the experience of most lenders and borrowers. Lenders say that they found, often at great cost, that in these circumstances the capital and operating costs of new developments were greater than expected.

> "Unfortunately, the arrival of high inflation and rent control is when we got squeezed. And by the late '70's, the developer was really squeezed."

3.3.2.1 Costs and Income

The typical relationship between the cost of construction of expected income was lost as expenses rose with inflation and

rental levels had to remain competitive.

> "From a quantitative standpoint, in the olden days, there was a very strong correlation between the costs of construction and the value by the income approach. So you did not run into the same measure of quantitative dilemma that you do today where certainly the income approach governs the lending... In lending on residential component, there is significant disparity between the value of a property by the income approach, as compared to the cost approach because the rents have not kept up with the costs."

Rental levels for new stock had to be reasonably competitive with those in the large rent-controlled stock. This depressed the incomes which could be generated from the new stock.

Some lenders, and developers, recognized the situation but thought that rent review would be temporary; consequently there was considerable apartment construction in the years immediately following rent review.

> "Into the mid-70's it [apartment construction] was really quite buoyant. Maybe there was a catch-up factor there that was not very entrenched at the time. I think there was a drag effect, and that developers, who are optimistic by nature, expected rent controls to be of a relatively short duration. They really did not change their planning very much initially. But as rent controls got more deeply seated, their bottom line cash flow was restricted [and] they pulled in their horns."

In the next few years as inflation increased along with capital and operating costs, the disparity between those costs and probable income made it increasingly difficult for many developers to put together acceptable loan applications.

> "He [the builder] can control what he pays his superintendent or his cleaning staff. But he cannot control his taxes, his insurance, or his heating bill. And these have each generally exceeded the inflation rate to which the rent control has been pegged. We end up saying, 'thank you, but no thank you, to these offers.' We are not going to invest our money in something that appears that it is

> going to lose money from day one. It is only going to be a problem."

One respondent, now associated with a development firm, said:

> "I cannot think of any person I know, now that the tax shelter is over, who would actually seek out a piece of land to go and build an apartment building for rental."

Another said:

> "There are no applications. Who is their right mind is going to build apartments? Bramalea built. Cadillac built. What are they doing now? Trying to buy Woodwards."

One lender said that not only did rent controls create many situations in which there was poor or negative cash flow, but those lenders who did participate in projects with negative cash flows did not receive a higher premium for the risks they took.

> "Meanwhile, rent controls had created a situation where there was a poor cash flow which could hardly be expected to attract lenders into the market. Unless there is a positive cash flow, most investors do not want any part of it, regardless of what the long term potential might be. Interestingly enough, those [lenders] who did go into the situation with a negative cash flow, did not command that much of a higher rate for their risk."

3.3.2.2 The Shift to Subsidized Construction

All lenders say the same thing: they do very little lending on new construction, and what lending they do is for subsidized buildings.

> "Any applications we see are not under rent control but they are subsidized. And those projects that are under rent control deflate the entire market. The non-rent controlled markets cannot raise their rates too much or there becomes too much of a gap between them and the controlled buildings. So the controlled ones artificially keep the other ones down. Twenty years ago, apartments were our biggest source of business. Today they are a very small part of our business. In Ontario, less than 5% of our business today is in apartment buildings, and most of that would be re-financing. I do not think we have financed a new apartment building for years and years. There are not any to finance except those that have gone under a subsidy program.

"The main requirement for an apartment to get built today is some sort of subsidy from government: The Ontario Rental Supply; CRISP; and a number of different programs through the past several years, and various lending assists that includedinterest-free second mortgages are what have made things work. Loans made under the NHA that permit buy downs of interest rates for non-profits and others are what have made construction work."

This opinion was echoed by a respondent with one of the largest lending organizations who stated that almost all new rental projects, except in the luxury class, are constructed with government support and that a builder would be foolish to build using only his own money.

"We have not seen any applications that I can recall of a pure developer wanting to put up rental accommodation with his own funds and borrowed funds without some support from some government or other... We have just not seen such an application. They are just non-existent because a developer without support would not make any money. He is better off to put his money into a bank account and collect the interest."

One or two lenders said that if the developer could find the bridge financing and obtain NHA insurance, then long-term lenders would put up funding.

"I think the financial problem we have had because of rent controls is more in getting the thing up. The NHA insurance policy is still so good that once you put your money out it is fully insured, there will always be a creditor. They players are changing, I think, and maybe I speak too much from the perception of my own experience. Once the building is up, there are lots of takers for the NHA paper."

This opinion, however, was in the minority. A more typical comment by a bridge lender was:

"As an interim lender, I would certainly want greater coverage and greater equity today. We are doing the odd one but very rarely. We used to do them by the dozens. Now we are seeing them very rarely. And what we do see are either subsidized or condominium."

3.3.2.3 Shortcomings of Subsidies

Several lenders noted that lenders had to be careful about relying upon government housing assistance programs especially when there were other easier avenues of investment.

> "We do not know how it can be jimmied around ... We want something that will support the free market. The subsidies were adequate, but they had the flavour of a rigged game, when there were lots of other games to play."

Another lender said that government assistance could not always compensate for the weaknesses created in part by rent control.

> "I have seen proposals laid on my desk which proposed negative cash flows for a period of years even with interest-free second mortgages from the government. Based on today's cost of construction and today's operating costs, and costs of construction including taxes, insurance, utilities, heating, there are relatively little of the operating expenses that are within the control of a landlord. And that is something that rent control fails to address."

Another lender said that the subsidy did not deal with the difficulty of refinancing after the first mortgage was due and the building was not obtaining economic rents.

> "If a developer did put up a building he would have to put in money to keep the thing afloat, to cover interest, principal, taxes, and expenses, Even taking into consideration the capital cost you are still going to have to put money in to keep the thing afloat without a subsidy. With a subsidy, it can work, but only until the fifteen years go by. That is the day of reckoning. That second mortgage comes due. And then you have to repay that mortgage, and you are going to need economic rents to do it. In today's climate there is not sufficient money to cover that. So what are we doing to ensure that there will be that kind of money available fifteen years from now?"

3.3.2.4 NHA Insurance

Several lenders said that NHA insurance was insufficient to compensate for long-term weaknesses in the market of which rent control was part.

"The financial intermediary borrows money from the public, and makes its money on the spread when it lends it out again. In operating its portfolio, it is matching its assets and its liabilities both as to term and as to rate. So, one would be foolish to go into an investment with the attitude that, if worse comes to worse, you will get your money back from the insurance. Because that will leave you with a large exposure on the rate, and on the term. When that money comes back you may not be in a position to reinvest it to match the remaining liability you have outstanding."

Another lender said:

"The NHA guarantee, by itself, allows the builder to get a 90% loan as opposed to a 75% maximum under conventional lending to which institutions such as ours are limited by law. The insurance by itself was attractive some years ago, because it allowed the builder to go ahead without a great deal of equity, and if he was satisfied to go ahead without a great return for the first several years, then the lender could be guaranteed its security of principal by the NHA insurance.

"The insurance by itself today is not a sufficient attraction because there is not enough revenue being generated by the building to provide for the servicing of the debt, with a comfortable cushion for the borrower.

"When we put out a loan for fifteen or twenty years, we are likely matching that loan against an annuity or some other commitment on the other end, and we are operating on the spreads between what we are paying on the annuity, and what we are earning on the mortgage. So, while the insurance guarantees that we will not lose our principal, if the loan goes into default, if that loan goes into default we have our principal assured but we do not have our income stream assured."

3.3.2.5 Disadvantaged Borrowers

Several lenders said that, because of the difficulties caused by rent control, they have to place more emphasis upon the quality of the borrower, which places the smaller builders at a disadvantage.

"And more and more the 'who' has probably got to be the key question in making lending judgments. Track record and equity on the balance sheet are far more important than they

> ever were... The developer who does not have a strong balance sheet and a very strong track record has probably got a tougher time doing a project now than he did five years ago. And that's not necessarily good. There are a lot of small developers who can probably do as good a job as any of the players in the market place."

A number of other lenders emphasized that the inability of the small builder to qualify for loans meant that a substantial amount of rental accommodation for lower and middle income persons was not being built.

> "Prior to 1975, we used to see a lot of the smaller walk-up type of apartment built by the individual investor as a retirement fund. And we would see them, as they built up equity in one building, start another one. That no longer happens because the replacement cost is far in excess of the earning capacity. So we do not see that type of apartment being built, which was really a very good basic accommodation for the lower to middle income person."

3.3.2.6 Government Restrictions on Lending

One lender noted that government regulations and policies, particularly since the Greymac affair, made it difficult to lend on risky projects even if the lender wanted to.

> "We were just looking at one this morning where they were looking for $2 million and I said it was only worth $1.4 million. So we had to work out a number of strategies to give them what they want, and leave us what we want. It just did not measure up. And, if we took the risk, the Department of Insurance would come in and ask how we can undertake that kind of lending. Traditionally, you can lend on 75% of the 'prudent value'. Now, the word 'prudent' has only just come in recently, not through legislation, but through meetings with the legal departments, Consumer Affairs, after Greymac, [and XYZ] and they are now interpreting the Act to mean 'prudent value'."

In summary. Rent review was instituted at a time when inflationary pressures grew to unprecedented levels. New units had to be price competitive with the large stock of controlled units, something builders found difficult to do. Except for luxury residential, lenders have found few projects eligible for loans unless government subsidies and incentives are involved. Even with subsidies and NHA insurance, lenders are cautious

because extended periods of negative cash flow can cause the borrower to default, exposing the lender on rate and term. The small builder is less able to obtain funding under these conditions than the larger builder and the smaller walk-up apartments are not being built as a result. Even if lenders are willing to take the risk, they might run afoul of government legislation and practices concerning "prudent value".

3.3.3 Refinancing Existing Buildings

The refinancing of controlled and uncontrolled rental units: the effects of rent control upon rental levels in uncontrolled units; the restrictions on cash flow; reductions in building value; vacancy rates; lenders' emphasis upon capitalization of income stream as indication of building value for purposes of lending; lenders' preference for the large owner with resources; effects on small owners and careful owner; foreign investors; recycling poor buildings; effects on municipal property taxes.

3.3.3.1 Reduced Refinancing

Lenders emphasized that the basis for lending on existing stock is the value of the building determined by the income. If the building is not generating an income it might be worth less than the accountants showed in their books. Consequently, a mortgage portfolio was only as good as the security of the real estate.

> "...the accounting industry that relies on balance sheets still have not figured out that real estate equity is, in essence, a non-liquid asset. If it is not generating a cash flow then it may not be worth a hundred cents on the dollar. Similarly, a mortgage portfolio is only as good as the underlying real estate security."

Lenders said that one effect of rent review had been a long-term reduction in the refinancing of existing rental stock.

> "There is very little financing of apartments done now partly because there is very little new construction. But certainly, there is very little refinancing done because the very severe restrictions on the cash flow due to rent control."

One lender said that buyers of apartment buildings could expect very low rates of return on their investments.

> "I do not think that the people who are buying them [apartments] now are going to be able to sell them in a year or two and get a return on their money. They are getting 5% before financing. If you put financing on, they will yield nothing. You wonder what the rationale is for buying these things."

One lender said that if lenders were reluctant to provide first mortgage financing on rent-controlled units, the lender who is asked to put up the balance is even more cautious.

> "There is another aspect about financing a building. When you talk about people who provide first mortgage financing, they do not like rent controlled buildings because they are never sure about their security, their security is still substantially better than the guy who comes in with the balance of the funds. The guy with a first mortgage gets paid ahead of any return on equity. If they are cautious about putting up the money on a rent controlled building, you can imagine that the guy putting up the last 15% or 25% is going to be more than double cautious."

Respondents noted that lenders had to be careful about projecting incomes from controlled units up for sale because projected increases above the approved limit might not be allowed.

> "Capitalization of the income stream. What is in place, not what is projected to be in place in a couple of years. On re-financing, quite often you get into problems. They have sold an apartment building and they are calculating that they are going to have a 16% or 18% increase in rent because of the new building cost aspect. That does not help us because it may never materialize."

Consequently, when buildings are refinanced, building values are based upon actual incomes and conservative estimates of projected incomes. This tends to deflate the value of the building and, therefore, reduce the amount the lender will lend on the building.

3.3.3.2 Deflating Values of Uncontrolled Units

Lenders also said that the large stock of rent controlled units were deflating rental levels in the uncontrolled stock and, thereby, the value of that stock.

> "The controlled market is definitely suppressing the non-controlled market. If a person sees a spread of $150 between two units in the same area, he will say, 'Why should I pay the extra? What's in it for me?'... Rent controls are also going to suppress the value of the property. Properties are not going to be marketable. Who wants to buy them? There is a real danger of somebody who buys with an expectation of losing for the first three years, losing for as long as they keep it. And then not be able to find a buyer if he cannot present the prospect to the buyer of a reasonable rate of return."

> "If there is one building in a neighbourhood that is outside of rent control, then you cannot expect to get phenomenally higher rates than the general area commands. They do have a little more scope, but they need to stay within reason when they move ahead of the rent controlled neighbouring building."

Lenders pointed to the Cadillac-Fairview sale as an example of the reduced value which rent review effects.

> "Look at the Cadillac-Fairview sale and what they sold for per unit. Nothing. Why? Only because of rent controls. ... the basic premise of those sales was that they had dropped from $40,000 per suite to $25,000. New suites are costing $60,000 and they are not selling for that because of rent controls."

One lender stated that rental buildings were fetching higher prices in British Columbia, where rent control had been removed, even though the economy was not as healthy.

> "Compare the current selling price in Toronto to the selling price of a comparable building in Vancouver where the market is non-controlled. We sold buildings in Ontario, not too long ago, and sold buildings in B.C. about the same time. The B.C. price was about 50% higher."

3.3.3.3 Vacancy Rates

All lenders were agreed that rent review had kept rents and vacancy rates in controlled units low.

Several lenders noted, however, that even though rent review kept vacancy rates low, it also kept cash flow down and made the building less attractive to potential buyers.

> "Rent control, because they keep the prices down, should keep the building pretty well full. Generally, there is a very nominal vacancy rate. The other side of the coin is that if the existing owner wanted to divest himself of that property he may have more difficulty because it does not make economic sense for someone to pick it up."

Lenders said the demand for the rent controlled units meant that lenders could assume the building would have a low vacancy rate and an assured income (within the limits of rent review); on uncontrolled units a higher vacancy rate would have to be assumed.

> "The only good thing about rent control is that you know that the rent levels are going to be low enough that there is always going to be pent up demand. You don't have the same concern about vacancy levels. So, to some extent you can ignore the realities of the market place... and not be concerned about the qualitative aspect of that income stream as impacted by location of the building or any number of other variables. ...rent controlled buildings are not usually taken at quite zero percent but at 2 or 3%. In a high rent building, you might say they are going for a premium dollar so we had better assign a 7% vacancy rate."

> "I do not think we have been asked to finance a non-controlled apartment for years and years. We have re-financed the units under control. As a landlord, the controls give you some comfort because you have no serious vacancy situation."

Several lenders thought that the low vacancy rate and assured income in the controlled units might be offset by poorer maintenance.

"There may be $150 difference between similar suites in a controlled and a non-controlled building. On the one hand, the controlled building you know will always be occupied. So that should minimize the risk. But you do not expect it to be maintained as well. On balance, I do not think you would differentiate very much. As far as return, it probably does not differ very much."

"The government may be subsidizing it, but there is no incentive for the management to be efficient in its operation."

Rent control is also seen as reducing the opportunities for someone to take a money-losing building and turn it around.

"If you have a bad building someone else can take it over, clean it up, analyze the market, overhaul the building to suit the market by changing the mix of apartment types. With rent control, I do not think there is the incentive to do that sort of overhaul. So you have foreclosed on the ultimate marketability of the building."

3.3.3.4 Lenders' Preferences for Uncontrolled Units

One lender noted that the uncontrolled, higher rent units offered the owner more investment options, despite the higher risk.

"Apartments that are out of rent control are worth more for two reasons: one, you have the ability to project income easier; two, they are worth more because the rentals are worth more. Thirdly, the speculative case that the upper income rental building can be converted into a co-op or a condominium is more soundly based.

"If there is a [financing proposal] that is tenuous, it is clearly much better at the higher level than at the lower level. People who are paying $1,000 a month for rental are capable of paying $60,000 when they are converted to condominiums. The people who are paying $300 at St. James Town are not capable, and there is no discussion. There always was a speculative premium somewhere for this alternative, and it still exists somewhere, but only at the higher levels. If you knock that out, you literally lose all hope.

"Anyone who wants to buy an apartment at least will logically choose to buy an expensive apartment."

Lenders also said they would lend more money on uncontrolled units.

> "So you have an ability in the non-controlled environment to generate a higher loan amount given the same building. You have a greater expectation of the increase in the rent. In a rent controlled situation, the manager has to be very efficient to maintain the initial level of rents, and work within the limits between his costs and his rents. The lender is not going to be so aggressive in the underwriting of the loan."

> "On balance, the lender would prefer the greater risk, with a higher rate of return, and more opportunity to manipulate cost factors by sound management."

> "If a banker had a hundred dollars to lend, and all other factors were equal, he would avoid the controlled borrower because the controlled borrower is not free to maximize the return on his investment."

3.3.3.5 Selecting Borrowers

In the refinancing of existing buildings, as in the financing of the construction of new units, lenders looked increasingly to the size of the borrower and his ability to weather unforeseen circumstances. In these circumstances the borrower with large assets is at an advantage and the borrower with fewer assets at a disadvantage.

> "The result is that the lender becomes much more aware of the quality of the balance sheet, not only in terms of underlying assets, and equally important the quality and durability of the cash flow, their ability to withstand interest rate shocks, not only in terms of the individual project, but corporately on the basis of the total operation."

The smaller owner is seen as less able to withstand the narrow profit margins of rent control and, therefore, as a less sound investment risk.

"Large developers, with professional managers on their staff, have a better chance in a tough market. They can buy supplies in bulk, and they can survive various economic squeezes. The smaller guy may not be less competent but he has not got the resources behind him to survive. They are often very conscientious, and that often makes a great difference."

Several respondents said that the small owners represented a large proportion of rental units across Ontario.

"But the number of apartments in small hands is totally underestimated. There are so many people running one little building, and if you add them all up throughout the whole province, it is a large number of rental units."

3.3.4.6 Effects on the Careful Manager

Several lenders emphasized that the operation of rent review discriminated against landlords, especially small ones, who were careful managers and paid off their debts, and favoured landlords who mortgaged their buildings heavily, thereby adding to their costs.

"I have always felt that the increase, as a granted figure, is greatly distorted because if you have an apartment building on which you have a very heavy debt, your costs are very much greater, and the rent review takes that into consideration. Therefore, it penalizes the one who saves.

"You not only have mammoth corporations like Cadillac Fairview owning apartment buildings. There are hundreds and hundreds of little guys who own buildings of twelve and fifteen units, who scrimp and save to get a down payment, and they are the new immigrant who came to Canada after the war, who have saved money to buy an investment. They are the kind of people who, if they have a mortgage of$100 a month, they pay $200 a month. They want to bring down their indebtedness. And because they are savers, they have been penalized because their income is being reduced. In other words, the fact that someone has a high mortgage while someone else has a low mortgage should not be a criteria for rent review.

"You buy a building for $20,000 a suite, and you put 10% down, and you have a debt of $18,000. That is a permissible expense. But, if you own the building, and you have saved

for years and years to make your mortgage payments out of other income to reduce your debt, as so many of these smaller apartment owners have done, you are penalized. And these small guys are just as much a part of the apartment industry as the big guys."

3.3.4.7 Effects on Foreign Buyers

Several lenders noted that there were no longer large numbers of foreign investors looking for apartments to buy.

> "There are people who buy and sell apartment buildings. But who is going to buy today? The days of the Hong Kong money, or the German money, or the South American money that used to buy apartment buildings ... thinking that inflation will take care of their profit, are gone."
>
> "As a Canadian, one of the positive things about rent control, is that it has taken the foreign investor out of the market to a large extent. They do not like regulation. They have come from countries where they had an abundance of regulation. And so they seek regulation free countries in which to invest. Now that has dried up to some extent. That has, in turn, reduced the end sale price of property. With the foreign investors reduced, the selling prices have come down a little bit, so that the developer has not got that surplus to start something new.
>
> "These were investors who were primarily picking up buildings after they were finished so that they were not contributing anything to the economy except bringing money into the country. But it was important money because it resulted in some property changing hands and developing a secondary market of capital.
>
> "Their absence is a positive effect of rent control. But it also does stop expansion. There are fewer bidders bidding on the properties which do come up for sale. This is a factor in the decline of the market.
>
> "The developer had that market, and he could trade freely. And if he had a good profit in that building he was likely to go on and build another, or perhaps two more buildings from the sale of that one. But he can no longer risk that option."

3.3.4.8 Effects on Municipal Taxes

Several lenders said that because of the low property values of controlled units, the other form of multi-family residential -

condominiums - had to bear a disproportionate share of municipal property tax.

> "If you look at the cost of a condominium when compared to the cost of rentals, you find that the condominium costs you 2.5 to 3 times the cost of rental building. This is on the sale cost, financed at 11% or 12%. .... As important as anything, you are going to one day find a very substantial drag on the tax structure of a municipality. Whether it is in five or ten years, you will see the condominium dweller paying three to four times the taxes paid by a person in a rental unit of the same size. Even today, if you compared the two units on the tax rolls you will see that the rental unit is a fraction of the condominium. That is an important ingredient of the ultimate position of the municipality. And these [rental] buildings will, as they deteriorate, require more services from the municipality, as they pay less. They will require more police protection, more everything, because of the type of tenant they will attract."

In summary. A mortgage portfolio is only as good as the underlying real estate security, and without a positive cash flow real estate is a non-liquid asset. Rent review deflates the value of controlled units, reducing the market value and amount of financing which can be obtained. The large stock of rent controlled units also depresses the value of uncontrolled units. The low vacancy rates in controlled units provide some security to lenders, but the owner may have trouble selling it because of the low cash flow. Lenders prefer to take the higher risk of lending on uncontrolled units which have higher vacancy rates but which are better able to respond to market pressures. Small owners are hurt most because they lack the assets lenders increasingly require. Rent control has been one of the factors which had taken foreign buyers out of the market. Rent control has also deflated the property value of apartments so that they bear a disproportionately low share of municipal taxes.

3.3.4 Effects On Building Maintenance

The effects of rent review on building maintenance: the effects on small and large owners.

Some lenders say that one of the effects of rent review is to reduce the incentives of the owner to maintain their buildings. There is such a demand for controlled units, because of their lower rents, that landlords do not have to compete for tenants

by maintaining and upgrading their units.

> "You get to the point where not only would you not want to build apartments. You would not want to own apartments. So you see them falling into the hands of people who will not maintain them. Who is to blame for that?"
>
> "There may be certain landlords saying that because there are no vacancies in the apartments why do anything for the tenant. I have not seen it personally, but I have no doubt that it probably exists. Particularly in the lower rentals. The landlord in those buildings may be doing the minimum that he can do, and to hell with the tenant."
>
> "Rent control is an unmitigated disaster because your value... If I have two partners, and one keeps the place up and one doesn't... It doesn't matter."

All lenders expressed the concern that controlled units would not generate sufficient incomes to pay for adequate maintenance.

> "Our own buildings have the same wear and tear as everyone else's. And I can see people saying to themselves, Can I get another year out of this carpet, or two more years out of this appliance? Because the name of the game is to defer expenses as long as you can."
>
> "...the owner cannot afford to maintain the painting cycles, the carpet cycles and all the other things that keep a building squeaky clean. In the non-controlled building, the landlord can maintain these cycles, and raise the rent to cover these costs as necessary. From the risk point of view, these qualitative aspects cause some concern, because there will not be the maintenance."

One lender said that the small owners find it particularly difficult to finance the maintenance of their buildings; but the large owners also find it difficult to finance their maintenance requirements.

> "You can split the market into two. The buildings owned by financial institutions like ourselves, or the major developers, who have a long range view; and, the smaller operations, almost like a family operation with the walk-ups. They are an important sector. And they are getting hit to the point that they have to patch a roof that needs to be replaced. They cannot absorb the losses in their

> other holdings. They do not have other holdings. There comes a point when our own maintenance will deteriorate even if we can hold on longer than the Ma and Pa building."

Another lender doubted that the government would allow rent increases which would be adequate to cover maintenance costs.

> "We also see a very substantial deterioration in the existing housing stock which is going to be more and more serious as time goes on, particularly, as the various political pressures come on the government to keep rental increases rising. Every time there will be a rent increase requested, it will be time consuming. It will be onerous. And the builder will say, 'The only thing I can do is to let the building deteriorate.'"

Unless landlords can be encouraged to upgrade their stocks on a continuing basis, the stock will decline.

> "Unless something can be done to encourage landlords to upgrade existing stock, then you are not going to have the stock that we had years ago."

> "You patch a roof which should be replaced. Then you have leaking. And before long you have a pretty crummy building. The extent to which that will happen will not be universal. It will depend upon the various owners. The people who are well financed and far seeing will take one approach. If they see that their investment does not come back to them they will sell the buildings at a loss. And the people who will own the buildings will be the people who can skinflint the building. That is what will ultimately develop."

Several lenders referred to the Cadillac Fairview sale of its substantial apartment holdings and the likely effects upon maintenance.

> "Cadillac Fairview is a typical example of a resale because they felt that rent control took away the chance of a profit. And they were a responsible landlord. They were known to be the outstanding landlords in the province. Now, it is anybody's guess how those buildings will be maintained."

In summary. Landlords of controlled units have a reduced incentive to keep up maintenance because demand for units ensures low vacancy rates. Controlled units do not generate sufficient income for adequate maintenance. Smaller owners are particularly hard hit, and larger owners are also affected. There is a danger that the rental stock will deteriorate.

3.3.5 Differences Among Different Areas

The extent to which rent review has differing effects in different areas of the province.

Respondents said that the pattern of severely depressed lending on rental units was fairly uniform throughout Ontario.

> "I do not think there are any major urban areas that demonstrate a difference in opportunity from the point of view of the lender, or the landlord, nor is there any great difference between Metro and any other large urban center. From that point of view, you like to have a large, stable market, and Metro certainly fulfills that bill. There is a greater difficulty finding a suitable piece of land in Metro, but other than that, no.

Because of its size, however, lenders thought there were more opportunities for new construction in Metro Toronto.

> "Metro has a very low vacancy rate which means that there is likely to be demand there, but you can still find buildings that are not fully leased in Metro. You would apply pretty well the same criteria whether it was Metro or any other major centre. I would not underwrite a building differently in London than I would in Toronto."

Lenders also said that in the smaller centres rent review effectively included the entire stock of rental units.

> "There are significant differences in financing in different markets. In smaller centres, everything is effectively rent controlled because there are few, if any, units above the $750 level. In larger communities, the renter has some choice; i.e., he can opt for the luxury accommodation which is not controlled, or stay within the controlled range."

In summary. In the smaller urban centres there are less likely to be units on the market which are not included within the purview of rent review, there is less likely to be a market for such units and, consequently, less lending opportunity. In Metro

Toronto, the market is sufficiently large that there is a demand for units which are above the $750 limit and, hence, more lending opportunities. In either location, the same lending criteria would apply.

3.4 THE CONTINUATION AND EXTENSION OF RENT REVIEW

Respondents were asked to comment on what they thought would be the consequences of:

(1) the continuation of the existing rent review system (including all units built before 1975 and renting for $750 or less as of October 1984);

(2) the extension of rent review to all rental units (universal rent review).

The respondents' comments were made with the knowledge that the Liberal Party had included universal rent review in its agreement with the New Democratic Party. However, the Government had not yet formally declared that this measure would be implemented.

3.4.1 Continuation of Rent Review

The likely consequences if rent review is maintained in its current form: what lenders would do; the effects on new construction; rent controls and long-term funding; trust in government; changing allowable rent increases.

3.4.1.1 Behaviour of Lenders

All respondents said that, if it were government policy to continue rent review, new apartment construction would continue not to meet their lending criteria, and there would be some refinancing of existing stock.

"As long as apartments are under rent control, the cash flow, expenses, and other factors which bankers necessarily consider will mean that apartment building will have a very limited ability to support the cost of the investment needed

> for construction. It will be harder to justify as complete coverage on the financing of new buildings. There will be some re-financing of existing buildings."

Several lenders said that the continuation of rent controls would drive the remaining lenders out of the rental field and increase competition among lenders in other markets.

> "There will be more and more lenders chasing after less and less stock. Or the same stock. With no new product coming on the market.... We may need to become more aggressive in going after mortgages on the single family home, or other places that will take up the slack left over from withdrawing from the apartment field. The apartment is attractive because it is an easier loan to service, and there are fewer of them, than when you finance a series of houses at $50,000. But there may not be the same benefits as having 100 individual home owners so that they will also get their RRSPs, and their car loans, and their deposit accounts,all at the bank. If this source of lending [for rental] dried up we would still find another source, and I think it would chiefly be in the real estate field."

A respondent with an insurance company said they would not re-enter the rental accommodation market so long as rent review was in place.

> "We are looking for the long run, and if they [the builders of new units] have to sell out a few years down the road to recoup their losses, then we do not have the investment that we thought we had, and it just does not make sense to launch into a venture that is guaranteeing losses, and you only hope to recover your losses from later increases or from sale. You can see why if an apartment building proposal lands on my desk with a proposal for the same investment into an office building, or a shopping centre, or a retail building, what I am going to choose."

3.4.1.2 Effects on Supply

All lenders said that the continuation of rent review would lead to a contraction in supply.

> "Under rent control, the long term prospects are a continuing contraction of supply without very strong government initiatives. That's proven and given. You are

still going to have a static or growing population of people who need rental accommodation. I don't think we can expect people's incomes to grow as they did in the '70s so that group who are not now adequately housed or housed only marginally is going to expand. How fast depends upon what assumptions you want to make about family formations, etc. An aging housing stock raises the question, 'Where will the stock come from to adequately house these people?'"

"The drop in increase could significantly worsen the already depressed market, especially for buildings which are already encumbered by a mortgage; which is probably about three-quarters of the existing stock, in my own estimate."

3.4.1.3 Psychological Factors

Discussion turned to the kinds of conditions which would bring investors, and builders, back into the residential rental market. A number of respondents emphasized that there were psychological as well as substantive factors involved. One consideration was that the natural optimism of the builders had eroded.

A lender who had been a builder said that trust was one issue.

"The position of the government was that buildings built after 1976 would not be subject to rent controls. Our company, for one, said there is no form of contract that will protect us. Others believed the government and did some building. Well, events now have indicated that once you get into rent control it is extremely difficult to get out of it. And we were right not to have built anything after 1974.

"So you come back to the fundamental question of whether with rent control is there any reason for anyone to build apartment buildings, and my answer is simply, No. If you want to do it as a social objective, then that is not a reason for a businessman, per se, to do it."

A respondent who no longer deals with apartment buildings, but who said that builders could be brought back into that market readily under proper conditions, stated that rent review had, over the years, reduced the builders' optimism: they no longer

believed that they could change the government's mind:

> "That's what development is all about, ignoring the conventional wisdom, and saying 'I can blockbuster my way through, I can change the way things are'. Other people take legislation the way it is written.
>
> "The developer says, 'I will change things.' We have had speculation over time whether the legislation will be changed. There are people who will speculate tomorrow. But the number of speculators is continually declining for the simple reason that the natural optimists are continually being reduced. Very few people believe that rent controls are going to be lifted. And costs continue to rise."

This lender compared rental accommodation to other areas of prospective investment. People, he said, do put money into all sorts of things that have a low initial rate of return - steel mills, pulp plants, hotels. They do it, he said, because they believe that it will all turn out well in the end.

> "But, you really have to be perverse to believe that it will turn out better in apartments."

Another respondent referred to this psychological factor.

> "What got worse is the outlook. The rate of return does not really matter. There are always people who will see an opportunity. But the outlook is steadily getting worse... When a friend was involved in selling off a series of very large apartments there was a considerable debate as to whether they were being just given away. But that controversy overlooked a basic fact. People develop real estate for the long term return in rents, as they acquire equity, and for the long term capital gain."

One lender also said that rent review had forced new units into a formula which allowed builders little room for error.

> "The essence of real estate is that it has to be flexible enough to forgive your mistakes. If you get enough return out of it, you can cover off your contingencies. If you come into a system where your returns are fixed, then there is no tolerance. If you have a system that will adjust to market more frequently, where real rates are higher than permitted rates, then I can have a mistake in my building,

and pick it up as I go along. You may not turn a profit until three years instead of a year or two because of that mistake. But you can still remain confident of recovery. If my profits are very precisely defined by ceilings on my income streams, then if I make one mistake, I can never pick it up."

3.4.1.4 Long-term Funds

Several lenders noted that the problem was not simply one of rent controls. The other problem was the availability of long-term funds at reasonable interest rates. The two problems were, however, related. Because of rent controls the owner could not adjust his rents to cover increased interest rates and, consequently, lenders were reluctant to advance long-term funds.

> "The two biggest things inhibiting construction today are the lack of long term funds and the price controls. If a developer builds today he has a mortgage for five years at 12%, and he has rent control. If, at the end of the five years, that inflation rate has gone to 15%, which has certainly happened in the past, he is in trouble. Because the numbers do not fit. The builder needs the freedom to move with the market rather than a different but fixed rate of increase."

He went on to say that if long term funds at low interest rates could be found then the builder could turn apartments into an attractive investment.

> "Low interest rates and long term money are what the developer would need to see to make apartments an attractive investment. If he had that economic environment, even with controls, you would see some development. But this combination is not likely to happen unless someone comes along with a new way of obtaining long term funds."

One lender said the funds were available to lend, but the government was in a dilemma.

> "The Government is faced with a 'damned if you do, and damned if you don't dilemma.' No political party wants to let rents go up, and on the other hand, if they do not do something about it [rent review], I do not see how they will

> get anyone to build apartment buildings. As lenders, we are willing. We view that the need is there. It is not being fulfilled because it is not profitable for the builders to build it."

3.4.1.5 Need for Government Intervention

All respondents were agreed that the continuation of rent control would lead to increasing public pressure for government intervention in and subsidisation of the rental market in order to protect existing stock and create new stock.

> "There will be demands on government to provide more and more subsidized housing at a higher per unit cost."

Several lenders emphasized that government is not well equipped to handle the production and management of housing. One lender who had been a builder said:

> "So you have effectively lost the choice of tenure. Undoubtedly, the government will have to step in and do a lot of building for the lower income brackets which will result in a deterioration in the sense that government cannot effectively operate apartment buildings. Most of the problems which we had were not between landlord and tenant, but between tenant and tenant. And this is where the government will fall down..... You are .... going to require massive government intervention in the market place at a high cost because they cannot build anything like we can build as an industry."

> "The building industry is not the type of business, like mass transit, or electrical generation, which can be well done by government. You are dealing with people's personal tastes. You are dealing with some twenty-five different disciplines which go into a building. Governments are not equipped to handle all that range of discipline efficiently and economically. So you are going to have very expensive social housing built which will be a drag on the rest of the economy. And, probably, as important as anything you are going to one day find a very substantial drag on the tax structure of a municipality. Whether it is in five or ten years, you will see the condominium dweller paying 3 to 4 times the taxes paid by a person in a rental unit of the same size."

3.4.1.6 Changing Allowable Rent Increases

At the time of the interviews, the then Conservative government had reduced the allowable automatic rent increase on controlled units from 6% to 4%. Respondents were asked to estimate what level of allowable rent increase would bring lenders and builders back into the market.

Government trustworthiness. Some lenders said that the issue was not the level of allowable increase, the issue was the trustworthiness of government and the changing of rules without accounting for the effects on the builder or lender or upon the stability of long-term lending.

> "The 6% is a capricious number. Once you are in the system, you are subject to the silent partner. But, I do not think the majority of developers will be taken in by the prospect of a higher percentage, if that percentage can be altered by arbitrary government decisions from year to year.
>
> "At some stage you design a subsidy program which will bring people out of the bushes, but merely raising an arbitrary number to a higher arbitrary number will not lead people to place their equity on the line, and take up apartment development. We have to look at fifteen-year mortgages with an assurance that we can take in an economic rent for each of those years. We cannot operate in an on-again, off-again way."

Asked about specific allowable increases - 4%, 6%, 8% - lenders differed somewhat. One lender suggested that higher allowable increases would improve the owner's position and, perhaps, maintenance standards. It would not attract new investors.

> "In my opinion, the raising of the maximum rate would not materially impact for a lot of reasons. Unless, it were tied to an objective of getting out of rent control there is always going to be the fear, justifiably, in my opinion, that the government may reverse its policy at any time. If the rate were increased to 8% or 9%, all that is going to do is to create a higher degree of equity for the owner, and maybe get a little better standard of maintenance. But it

> is not going to attract the person who would build a new building, because there is no assurance that that 8% will not be dropped to 4% at some future time."

One lender said 6% was already so low, 4% made no difference.

> "The lowering of the maximum increase from 6% to 4% will simply further discourage prospective investors. However, 6% is already such a strong disincentive that the further reduction will not make an awfully great difference."

Other lenders spoke of the need to relate the increase to the inflation rate. One lender said that the situation would improve if inflation stayed at 4% and rents increased at 6%; the difficulty was that the risk associated with possible future government actions demanded a higher rate of return.

> "The mere presence of controls is the significant factor. But the other thing to look at is the relationship to the rate of inflation. Right now we have a rate of inflation of about 4%, so if you were to leave it [allowable rent increase] at 6%, what you would find, if inflation stayed low, is that you would have a gradually self-correcting problem. Their capacity to pay rent is not going to change as quickly. but there would be a catch-up period so that controlled rents would start getting close to market rents, and you could start to think of taking that ceiling off. That would be one scenario of how you could handle this politically.
>
> "But as long as you have that rental ceiling there, you are going to have a nervous market. You are going to have to require much higher rates of return. The increase to 8% would solve your problem faster. If your uncertainty is higher, you require a greater rate of return to take the risk."

Several lenders thought that 8% would be sufficient, if inflation stayed at about 4%.

> "I think the government is going to have some sort of control in there. But if it went from 6% to 8%, I think you could start to see some activity in the apartment industry. I think that 2% could be critical. It would be psychological for sure, but it would also put money in their pockets which they cannot make right now. They would probably think 8% would be something more reasonable."

> "To bring it down from 6% to 4% would be asinine. To bring it up to 8% would get something going in the rental market. I think you could see the people who want to have an investment in an apartment building starting to think in terms of, Hey, maybe we can make a living in the apartment business. There is a market there for apartments if it can be made to look like there is a buck there for the builder."

No one seemed to think a 4% increase was adequate,

> "There is no question that that (4%) will have a further suppressing effect. We know of one major project that is on hold right now until the developer finds out the results of that decision. That is a very critical margin. It is also psychologically negative to the industry too, because they are hoping for some relaxation of the six and instead it is being tightened."

One respondent thought that the reduction to 4% would endanger the existing stock

> "I can see many buildings not being maintained, and some developers just getting out of the business. Taking their losses and letting someone else run it."

unless the borrower can service the debt.

> "If we believe that we are going to continue into an environment of further disinflation with 8.5% mortgage rates then a 4% rent increase might be manageable. But, as a general rule, the problem is not the availability of funding, but the ability of the borrower to service the debt. And that is always going to be a constraint. We are operating off a 30% to 40% gap."

3.4.1.7 Effects on Tenants and Others

All lenders stated that the continuation of rent review discriminated in favour of existing tenants and against future tenants and the poor.

> "The net result of this, as far as I am concerned, is not a tragedy for the investor. He has other places to put his money. It will be a tragedy for the renters of the city who do not understand or realize what they are doing to themselves. Particularly, the renters of the future. The results will be a very substantial increase in the cost of

accommodation except for that very favoured few who are in existing rental buildings."

Rent controls encouraged middle class tenants to stay in their units rather than move to uncontrolled, more expensive units or into houses. Consequently, there was no room for new tenants who needed inexpensive accommodation.

"The fact that there are units under rent control tends to hold down the value of other units which are not officially controlled. And people who are living in a controlled unit who could well afford to move out, do not move because they want to hang on to the bargain that they are getting. So that in turn means that new construction is not being stimulated, and those who need those less expensive units do not find that the protected accommodation is available to them."

"It does not benefit the poor. It benefits the middle class who do not buy homes. The whole building industry would be in much better shape if these people who are not buying homes, because they are paying very low rental, would go out and buy homes. And that would increase apartment vacancies."

"At least half the people who are benefiting from rent control can well afford the going rate. So you are subsidizing the people who are not in need. It is so inequitable, that is the problem. Even without a career advance, if you look at the inflation rate from '74 to '78, and the rate at which salaries advanced during that period, when rents did not go up at the same rate. The average tenant is not going to give you comparable numbers from this same period, but at least fifty percent of the tenants out there have to be really in the clover, benefitting from rent control."

3.4.1.8 The Abolition of Rent Controls

Asked about possible effects of the abolition of rent controls, most respondents said there would be short-term difficulties and then the market would sort itself out. Respondents assumed that the abolition would be phased over time.

"If the controls were lifted, what would happen is that there would be a year of panic, and then it would settle

down and come back to the market place, and the market place would govern. Mortgage rates would come down, in my view, because there would be more product out there, and the market place would force the rates down. I think it would work through that cycle from panic to stabilization in two to three years. That is a judgment on my part.

"If rent controls came off today, there would be a boom in construction in 1986. There would be an absolute go. That's how fast I think it would work through the system."

"If rent control were cut off suddenly it would create turmoil. It is something that is so ingrained that it has to be done away with gradually. Whether it should be $25 a year or some other figure can be worked out by other people who are more expert in such questions than I am."

"I understand the political ramifications of getting out of rent control. The position we expressed to the government a number of years ago was to change your maximum to $750 for a three bedroom, $650 for a two bedroom; and, any suites which become vacant become de-controlled, so that the hardship is not visited on the people within the building. This would get us out of rent control within a ten year period. I am rather sorry that the commissioner did not see that."

In summary. If rent controls were continued, lenders said there will be even fewer funds for new construction and that more lenders would leave the market. New supply would contract even further. The psychological outlook would worsen. Builders would return to the market only if the government provided written contracts. Long-term funding could not be made available. More government intervention would be required. Builders and lenders would return to the market if rent increases were related to the rate of inflation. The reduction of the rent increase from 6% to 4% would reduce supply even further. The system favours existing tenants and the middle class over new and poor tenants. Phased removal of rent controls would cause immediate concern and a boom in rental constructions.

3.4.2 Universal Rent Controls

The effects of extending rent review to all rental accommodation: effects on small and large landlords; the government as landlord; effects on the poor.

Lenders comments on this scenario are similar to those on the continuation of rent control. All lenders said that instituting universal rent control would worsen a situation they regarded as

bad already. One lender said that the large as well as the small owner would be driven out of the business.

"There had been an expectation that the larger operations would be able to work within the limits of the existing rent control program although the smaller operator was clearly being driven out of the market. But with the application of universal rent control and a ceiling of 4%, there will be no way to go into any of these deals with negative cash flows. At a 4% growth rate, a person will never get his operation to a profitable level."

One respondent, now with a builder, said that universal rent rent review meant the cancellation of a large rental housing project which his company had planned to build.

"We have been one of the major participants in these assistance programs because we have a big hunk of land which we want to develop rather than just continuing to hold on to it. We have industries which provide an employment base to people who choose to live there. But, under the conditions which are emerging there is no way that we can provide apartment units for people to live there. The units we would have built there would not have been under rent control because they would all have been post-'76. Which meant that we could set an economic rent. That opportunity is now being taken away."

One respondent referred to the effect upon employment.

"The universalization of rent control will further slow down or completely disappear the market. It will prevent the construction of the higher value buildings which were initially exempted expressly for the purpose of encouraging their construction."

The following comments are typical of most respondents:

"In the long run, the stock of rental housing is going to run down. Nothing is being built, and nothing is being improved. And, if you were a landlord, what would you do?"

"I think that we would have absolute disaster. You would be down to no construction and no vacancy and all kinds of pressure. Some projects have gone ahead with the developer realizing that he is going to have to rely on subsidies, but that in three or four years it will come on side for him.

Now, with what you are suggesting, he will no longer be able to see that day."

"Universal rent control would just be a restraint on the whole market. It's been tried all over the world. New York, England. The government has got to assume the responsibility of providing rental units if the market place does not provide them."

One respondent said that the government would have to set out a written contract before its word would be accepted by builders.

"Apartment buildings built after '76 are now going to go under rent control as well. This is a breaking of faith with the industry. And even if the industry was told today, you are not going to go under rent control, they would not believe it any more. If you cannot trust the government's undertaking, then you have a threat, and I do not think that any government undertaking that is not in the form of contract in future will be accepted. ... Unless, it were tied to a contractual program which said, We will raise rents by 8% per annum until the vacancy rate goes to 3%, or 2.5% and then we will get out of rent control. Unless there is some mechanism for ensuring that that is going to happen then I say that it will not impact on new construction significantly."

Several respondents stated that universal rent review benefitted people who did not need help.

"The problem with universal rent control is that it really makes no sense. Rent control was meant to protect people who could not protect themselves. But people who are paying $1,000 a month do not need protection. It's contrary to natural economic law. If you want to put price control on lettuce, so be it. But why put it on caviar? It's really irrational."

In summary. Universal rent control will worsen an already bad situation. Large as well as small builders and owners will be driven out of the market. Proposed rental projects will be delayed or cancelled. Universal rent control will protect the affluent who do not need protection.

APPENDIX

Appendix

INTERVIEW SCHEDULE

1.0 Regarding the financing of residential rental accommodation, could you review your sector's performance, and the way in which it has changed from 1965 to 1975 and 1985?

1.1 Thinking back to pre-rent control, what were the bases on which you normally lent funds to residential rental construction?

- coverage
- economic market value
- interest rates
- landlord's return on investment
- risk
- liquidity

1.2 Indications are that the financing of residential rental had begun to deteriorate by the early to mid '70s.

Whatare your recollections of that period? Were expenses increasing faster than revenues? Or than the cost of construction per unit? What was happening to the expenses as a percentage net of p.i.t?

1.3 What is the current situation with respect to the financing of residential rental?

- cost of units
- coverage (lending ratios)

1.4 Are there any reports or studies on documentation of these changes which would be helpful to us?

2.0 Thinking about these lending practices, to what extent, if any, are rent controlled units treated differently from non-rent controlled units?

2.1 In your opinion, what are the differences, if any, between rent controlled and non-rent controlled units with respect to

- lending risk
- liquidity
- rates of return
- quality of the building, (maintenance)
- quality of management?

2.2 Are there significant differences in financing depending upon the location of the building or the municipality in which it is located, whether inside or who are not managing the financing of their buildings as well as they might? Is this having a significant effect upon the retention of their units in the housing stock? To what extent does this occur?

4.0 The maximum annual rent increase allowed without having to go to the Residential Tenancies Committee is now, or will be, 4%. (It used to be 6%) What effects, if any, will this lower rate have upon the financing or re-financing of the existing stock of rent controlled units?

4.1 What effect will it have on the existing stock of non-rent controlled units, i.e., the supply of new units?

4.2 There are proposals that rent review be made universal - or apply to all but the most expensive units. If such a proposal were implemented what would be the effects, if any, upon the financing or re-financing of

- the existing stock of rent controlled units?
- the existing stock of non-rent controlled units?
- the supply of new units?

4.2 What do you see as the long term prospects for the financing and re-financing of rental units under the current rent control system?

Research Studies

The following is a list of papers commissioned by the Inquiry.

No.

1 Slack, Enid and Sherry Glied. Rent Registry Alternatives.

2 Reid, Frank. Collective Bargaining for Tenants.

3 Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.

4 MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.

5 Fallis, George. Possible Rationales for Rent Regulation.

6 Hulchanski, J. David. Market Imperfections and the Role of Rent Regulations in the Residential Rental Market.

7 Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.

8 Marks, Denton. Housing Affordability and Rent Regulation.

9 Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.

10 Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.

11 Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.

12 Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.

13 Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.

14 Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.

15 Stanbury, W.T. Normative Bases of Rent Regulation.

16 Stanbury, W.T. Normative Bases of Government Action.

17 Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.

18 Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.

19 Chant, John. Overview of Alternative Rental Housing Policies.

20 Foot, David K. Housing Demands: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.